Supreme Court, U.S.
FILED
05-1774 061160 FEB 23 2007
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IN THE

Supreme Court of the United States

ALAN NISSELSON, Trustee of the Dictaphone Litigation Trust, successor-in-interest to claims of Dictaphone Corporation,

Petitioner,

—v.—

JO LERNOUT, *et al.*,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Where an acquiring company succeeds in fraudulently merging with its target, and the target's securities fraud claims pass first to the defrauding acquirer's subsidiary as a matter of law, and thereafter to a bankruptcy estate and a litigation trustee, may the trustee be denied recovery on the ground of *in pari delicto only* if the two-part test adopted by this Court in *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299 (1985) is met?

2. Does a trustee or receiver "bear at least substantially equal responsibility for the violations he seeks to redress" as "a direct result of his own actions" thereby satisfying the first prong of the *Bateman Eichler* test whenever principles of imputation make him responsible for the wrongs of a "guilty" predecessor?

3. Does Section 541 of the Bankruptcy Code require a finding that a trustee acquiring the claims of a debtor bears "equal responsibility" as "a direct result of his own actions" for the wrongs underlying those claims whenever the debtor would have been found to have "equal responsibility"?

4. Does a rule of law denying recovery to all trustee successors for all defrauded merger targets "significantly interfere with the effective enforcement of the securities laws and protection of the investing public" under the second prong of the *Bateman Eichler* test, thereby requiring the defense to be denied?

5. Does Section 541 of the Bankruptcy Code create a federal rule of imputation consistant with this Court's ruling in *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994), thereby requiring all trustees obtaining rights to claims in bankruptcy to be found *in pari delicto* on all state law causes of action whenever the debtor would have been so found, irrespective of the provisions of state law otherwise governing the claim and defense?

LIST OF PARTIES – Rules 14.1(b) and 29.6

A. Parties Originally Named in the District Court.

Jo Lernout; Pol Hauspie; Nico Willaert; Gaston Bastiaens; Carl Dammekens; Ellen Spooren; Ju-Chul Seo; Erwin Vandendriessche; RVD Securities N.V.; Dick Cauwelier; Marc G.H. DePauw; Francis Vanderhoydonck; Gerard van Acker; S.A.I.L. Trust V.Z.W., Flanders Language Valley Fund; Flanders Language Valley Fund Management; Lessius Management Consulting, N.V.; Gewestelijke Investeringsmaatschappij Vlaanderen N.V.; L&H Investment Company, N.V.; Language Investment Company; Language Development Services: Mercator and Noordstar N.V.; Language Development Fund; Velstra Pte Ltd., Louis H. Verbeke; Willem Hardeman; Tony Snauwaert; Klynveld Peat Marwick Goerdeler Bedrijfsrevisoven; KPMG LLP; Paul Behets; SG Cowen Securities Corporation; Chase Securities, Inc., as successor to Hambrecht & Quist; Deloitte & Touche; Stonington Partners, Inc.; Stonington Capital Appreciation 1994 Fund L.P.; Stonington Holdings, LLC; John H. Duerden; Albert J. Fitzgibbons, III; Emil F. Jachmann; Alexis P. Michas; Scott M. Shaw; Joseph D. Skrzypczak; and Peter P. Tong.

B. Changes of Parties in the District Court.

The District Court entered judgment solely as to Jo Lernout; Pol Hauspie; Nico Willaert; Gaston Bastiaens; Carl Dammekens; Ellen Spooren; Ju-Chul Seo; Erwin Vandendriessche; RVD Securities N.V.; Dick Cauwelier; Marc G.H. DePauw; Francis Vanderhoydonck; Gerard van Acker; S.A.I.L. Trust V.Z.W., Flanders Language Valley Fund; Flanders Language Valley Fund Management; Lessius Management Consulting, N.V.; Gewestelijke Investeringsmaatschappij Vlaanderen N.V.; L&H

Investment Company, N.V.; Language Investment Company; Language Development Services: Mercator and Noordstar N.V.; Language Development Fund; Velstra Pte Ltd., Louis H. Verbeke; Willem Hardeman; Tony Snauwaert; Klynveld Peat Marwick Goerdeler Bedrijfsrevisoven; KPMG LLP; Paul Behets; SG Cowen Securities Corporation. Chase Securities, Inc. and Deloitte & Touche are no longer parties to the action. The case to the remaining parties is pending.

C. Changes of Parties in the Court of Appeals.

None

CORPORATE DISCLOSURE STATEMENT

The Dictaphone Litigation Trust is a trust, without shareholders, parents or subsidiaries. KBC Bank, N.V. and Fortis Bank, N.V. each have a beneficial interest in the Trust exceeding 10%.

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OPINIONS BELOW

The opinion of the Court of Appeals is reported at 469 F.3d 143 (1st Cir. 2006) and is reprinted in the Appendix hereto at 1a to 25a.

The opinion of the District Court granting the Motion to Dismiss the Amended Complaint filed by SG Cowen Securities Corporation ("Cowen") is reported at 2004 U.S. Dist. LEXIS 13648 (D. Mass., July 21, 2004) and is reprinted at 26a to 40a. A further Memorandum and Order allowing the motions to dismiss of various other defendants is not reported and is reprinted at 41a to 42a. Two unreported orders of the District Court granting the motions by certain defendants for an order pursuant to Rule 54(b) to enter a separate judgment of dismissal are reprinted at 43a to 45a, and 46a to 48a. A further unreported order of the District Court amending the prior judgment to correctly specify the parties against whom all claims were dismissed is reprinted at 49a to 50a. An unreported order of the Court of Appeals pursuant to Rule 60(a), allowing the District Court to enter the corrected judgment is reprinted at 51a to 53a.

JURISDICTION

The District Court had subject matter jurisdiction of this action pursuant to Section 27 of the Exchange Act, 15 U.S.C. § 78aa, 28 U.S.C. §§ 1331 and 1337, and the principles of supplemental jurisdiction under 28 U.S.C. § 1367. The Court of Appeals affirmed the District Court's dismissal of the claims against certain named defendants on November 8, 2006. Pursuant to the Order of Justice Souter dated February 2, 2007, this petition is due to be filed on February 23, 2007. This Court has jurisdiction pursuant to 28 U.S.C. § 1254.

PERTINENT CONSTITUTIONAL AND STATUTORY PROVISIONS

Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), Rule 10(b)(5), 17 C.F.R. § 240.10b-5(2000), and the pertinent provisions of the Racketeer Influence and Corrupt Organization Act, 18 U.S.C. §§ 1962 and 1964 are reprinted in the appendix hereto at App. 54a to 63a.

STATEMENT OF THE CASE

A. INTRODUCTION

This case involves the proper scope of the *in pari delicto* defense when it is asserted against a claim by a Trustee or receiver who has inherited the claim from a wrongdoer. Both logic and experience indicates that this is the context in which the defense is most likely to be raised since a corporate wrongdoer is most likely to sue its confederates after those in charge of the wrongful acts have lost corporate control.

Absent clear guidance from this Court on the issue, and there has been none, it is perhaps not surprising that the issue of whether a Trustee is continued to be burdened with the *in pari delicto* defense to the same extent as his predecessor-in-interest is one which has deeply split the circuits. What is surprising, however, is how frequently the circuits have decided the issue without reference to the governing precedents from this Court, and that even those who did address this Court's requirements applied them inconsistently.

The application of the *in pari delicto* defense in federal courts is governed by two decisions of this Court, both of which were misapplied by the First Circuit below. In the first, *Bateman Eichler, Hill Richards, Inc.*

v. Berner, 472 U.S. 299 (1985) this Court held that a private securities fraud suit for damages, or other like cases involving federal law claims implicating the public interest, "may be barred on the grounds of the plaintiff's own culpability *only* where"

> (1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public.

Id. at 310-11, emphasis supplied.

In the second, *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994), this Court held that in contrast to those strict requirements for allowing the defense in cases arising under federal law, where the claims asserted arise under state law, then, state law principals alone govern the application of the defense to those state law claims.

In determining the critical issue under the first prong of the *Bateman Eichler* test, whether the Trustee's liability in this case is "substantially equal" to that of the defendants, the First Circuit ignored *Bateman Eichler* and the policies behind it. Instead, the court of appeals focused exclusively on the "genealogy" of the Trustee's claim, as having passed through the hands of a wrongdoer. Although the claim rose in innocence as a claim of a defrauded merger target, and was asserted by an innocent trustee, acting for the benefit of the innocent creditors, the First Circuit applied a mechanical test. It held that a bankruptcy trustee, and therefore the Trustee in this case, "stands in the shoes" of his predecessor, and is barred by *in pari delicto* if his predecessor would have been. As we show below in Point 1.A, this approach is

contrary to the *Bateman Eichler* rule and long standing concepts of equity jurisprudence.

The second prong of the *Bateman Eichler* test was misapplied following the same mechanical approach. Since the Trustee was found by the court of appeals to be a "guilty" participant (by imputation), the policies of the securities laws were not interfered with since those laws do not exist to give wrongdoers a "second bite at the cherry." App. at 23a. Allowing the resolution of the *Bateman Eichler* "equal guilt" prong (particularly when guilt is solely through imputation) to determine the result of the "significant interference" prong, effectively nullifies the second prong of the *Bateman Eichler* test. Further, as we show in Point 2 below, a rule of law that insulates from suit those who participate in fraudulent corporate acquisitions clearly does interfere with the "effective enforcement of the securities laws and protection of the investing public," and for that reason alone the decision below merits reversal.

The court of appeals also dismissed the state law claims using its court devised federal law of imputation which, as we show below in Point 3, is contrary to this Court's holding in *O'Melveny* and contrary to governing Massachusetts law.

This case calls for review by this Court, however, not merely because of the errors of the First Circuit below, however serious, but because those similar failures to apply this Court's rulings in *Bateman Eichler* and *O'Melveny* have occurred in case after case, and in growing numbers, and will continue to occur until this Court clarifies the issues. The First Circuit decision in this case below followed the Eleventh Circuit in *Official Committee of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145 (2006) which contained the same errors.

The Third Circuit in *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 357 (3d Cir. 2001) applied *in pari delicto* to bar federal and state law claims of a creditors' committee without even citing *Bateman Eichler*, and by applying a federal standard of imputation, contrary to the command of *O'Melveny* and of Pennsylvania law which governed the state law claims. *See* Point 3, *infra*. In *In re The Personal and Business Insurance Agency v. McNamara*, 334 F.3d 239 (3d Cir. 2003), the same circuit, again without citation to *Bateman Eichler*, held a bankruptcy trustee *was not* prohibited from recovering fraudulent conveyance based on the debtor's participation in pre-petition fraudulent conveyances.

The Seventh Circuit reached the conclusion in *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995) that "the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated." Citing Illinois cases and Supreme Court precedent, but notably not the *Bateman Eichler* decision, the defense was rejected for both federal securities and state law claims.[1]

Similarly, the Eighth, Sixth and Tenth Circuits have held a bankruptcy trustee's state law claims is barred by *in pari delicto* if his predecessor would have been using federal court made imputation law in violation of the rule in *O'Melveny*.[2] The Second Circuit has followed its

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[1] *Accord FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) ("While a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on . . . [an] innocent entity that steps into the party's shoes pursuant to court order or operation of law.")

[2] *E.g., Grassmueck v. Am. Shorthorn Ass'n*, 402 F.3d 833, 836 (8th Cir. 2005) (applying *in pari delicto* to bar state law claims of bankruptcy trustee based on federal court made imputation rule); *Terlecky v. Hurd (In re Dublin Sec)*, 133 F.3d 377 (6th Cir. 1997), cert. denied, 1998 U.S. LEXIS 4792 (October 5, 1998) (same); *In re:*

own drummer and held that a bankruptcy trustee loses standing to assert claims where the debtor has participated in the wrongdoing.[3]

This large and growing list of circuit court cases disregarding or conflicting with this Court's governing opinions and the still larger number of district court and Bankruptcy Court cases containing the same defects, have undermined the continuing vitality of both *Bateman Eichler* and *O'Melveny*. There can be little doubt that this case, presenting errors in application of both of those precedents, merits review by this Court to clarify the proper application of *Bateman Eichler* and *O'Melveny* to suit by trustees and receivers.

B. STATEMENT OF THE FACTS

On May 5, 2000, in a merger pursuant to Section 259 of the Delaware General Corporate Law, Dictaphone Corporation ("Dictaphone" or sometimes "Old Dictaphone") transferred all its assets and its business, then valued at approximately $900,000,000, to Dark Acquisition Corp. ("Dark" and subsequent to the merger, "New Dictaphone"), a newly-created wholly-owned subsidiary of L&H.

The Merger Agreement, which was executed on March 7, 2000, contains representations and warranties from L&H to Dictaphone in Article IV, including representations concerning the accuracy of filed financial statements. Those representations were the subject of extensive "due diligence" by Dictaphone and in the course of

Hedged-Investments Assocs., Inc., 84 F.3d 1281 (10th Cir. 1996) (same).

[3] *See, e.g., Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991); *Mediators, Inc. v. Manney (In re Mediators, Inc.)*, 105 F.3d 822, 825-26 (2d Cir. 1997); *and Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1094 (2d Cir. 1995).

which defendants made face-to-face representations to Dictaphone, upon which Dictaphone relied. Dictaphone itself hired professional advisors, who were also subjected to misrepresentations from defendants in performing their work for Dictaphone.

Unknown to Dictaphone, the consideration it received for its transfer of $900,000,000 in business and assets, including (but not limited to) stock of L&H and the assumption of Dictaphone's liabilities, was essentially worthless due to the existence of a massive fraudulent scheme to artificially inflate L&H's reported revenues and profits which L&H had been engaged in since at least 1996. As a result, within months of the merger, both L&H and Dictaphone were forced into bankruptcy and Dictaphone lost nearly its entire net worth.

The L&H scheme involved the use of related or controlled companies through which L&H would funnel loans or venture capital, or sometimes its own money, which would then be given to L&H and fraudulently recorded by L&H as revenue. Initially, the scheme involved two corporations called Dictation Consortium and the Brussels Translation Group ("BTG"). The scheme was later expanded to a series of twenty so-called Language Development Companies ("LDCs") and Cross-Language Development Companies ("CLDCs") (the "LDC/CLDC Fraud"). Like the Dictation Consortium and BTG, the LDCs and CLDCs were effectively controlled by L&H, but that relationship was concealed.

Following the acquisition by L&H of a Korean telecommunications company, Bumil, in September 1999, L&H also embarked on a related fraud to enter into sales contracts at wildly inflated prices with a series of essentially shell companies, and to fraudulently book the revenues from these contracts, even though the pur-

chasers had not—and could not—pay the contract price (the "Korean Revenue Fraud").

L&H ultimately admitted that various fraudulent schemes inflated L&H revenues in the period 1998 through June 2000 by $373 million, nearly two-thirds of the total, and the profits of L&H, reported to Dictaphone at the time of the merger as $70 million, in actuality was a $70 million loss. L&H, which had boasted a market capitalization of $8 billion, was essentially worthless. Defendants were all alleged to have directly participated in the L&H scheme. Absent the fraud, Dictaphone never would have agreed to the merger.

Upon discovery of the fraud, L&H and its fraudulently-acquired subsidiary Dictaphone were compelled to file for protection under the United States Bankruptcy Code. Pursuant to Dictaphone's plan of reorganization, Dictaphone's claims were assigned to the "Dictaphone Litigation Trust," of which Plaintiff-Appellant, Alan Nisselson, is the Trustee. Plaintiff-Appellant, by this action, seeks to recover the "damages suffered by Dictaphone as a result of the fraudulent course of conduct."

The damages alleged in the Amended Complaint are identified generally as "including, *but not limited to*, loss or diminution of its value as a going concern and consequential damages in an amount to be proven at trial, but no less than $900,000,000." The $900,000,000 number corresponds to the value of Dictaphone business and assets which it surrendered in the merger. The Amended Complaint does not assert any claim or cause of action premised on any injury, other than injuries to Dictaphone.

C. THE DISTRICT COURT DECISION

The District Court addressed the issues presented by the dismissal motions as sub-categories of the issue of

standing. The Court found that the case was "much complicated by the fact that the bankrupt corporation was wholly-owned by the alleged perpetrator of the fraud." App. at 34a. The Court first addressed the issue of *in pari delicto*. Significantly, although federal securities fraud and RICO claims were asserted, the District Court did not even mention, let alone address, the standards governing the application of the *in pari delicto* defense to Federal claims as set forth by this Court in *Bateman Eichler, Hill Richards, Inc. v. Berner et al.*, 477 U.S. 299 (1985); and *Pinter v. Dahl*, 486 U.S. 622 (1988). Nor did the District Court evaluate the state law claims applying Massachusetts state law principals[4] as required by this Court's decision in *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994).

Instead, the District Court, relying primarily on the Second Circuit's decision in *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991) and its progeny,[5] the District Court held that "Courts have consistently held that claims for fraud or misrepresentation perpetrated on investors belong exclusively to those investors to the exclusion of the corporation or its successor in interest, where the corporation itself was

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[4] While the district court did not discuss choice of law issues Massachusetts, the state where the merger was consummated, L&H and Dark existed and many of the fraudulent misrepresentations occurred was the state whose law would apply to the dispute.

[5] *Mediators, Inc. v. Manney (In re Mediators, Inc.)*, 105 F.3d 822, 825-26 (2d Cir. 1997); *and Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1094 (2d Cir. 1995). The district court also relied on *E.F. Hutton & Co. v. Hadley*, 901 F.2d 979, 987 (11th Cir. 1990), where a trustee for the perpetrator of a Ponzi scheme, GIC, had no standing to on claims belonging only to GIC customer creditors, and *Williams v. California 1st Bank*, 859 F.2d 664, 666-67 (9th Cir. 1988), where a bankruptcy trustee was held not to have standing to pursue creditors claims which the trustee had received by way of assignment.

involved in the wrongdoing." App. at 35a. The court dismissed the Trustee's argument that "Old Dictaphone" was the victim of the fraud holding: "Old Dictaphone cannot arise Phoenix-like to assert pre-merger claims against third parties that New Dictaphone could not assert." App. at 36a.

As an alternative ground for its holding that the Trustee had no standing, the District Court held that the loss of value resulting from a stock for stock merger was injury either directly to the shareholders, or directly to the creditors. App. at 39a-40a. The court found any separate harm to the "value of the corporation as a going concern" to be "speculative." App. 40a. Applying the test established by the Delaware Supreme Court in the then-recently decided case of *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), the District Court found no standing on that ground as well. *Id.*

D. THE COURT OF APPEALS

While the Court of Appeals affirmed the District Court, it did so under very different reasoning. The Court rejected entirely the standing conclusions of the district court. It held that the *in pari delicto* defense is an "affirmative defense," not a matter of "standing." App. at 9a. It also held that the issue of *who* has the right to assert a claim (in this case the shareholders, as held by the District Court, or the Trustee) turns on a question of prudential standing not Article III standing, and therefore need not be resolved as a threshhold matter. App. at 10a. The court declined to address what it considered an unsettled matter of Delaware law. App. at 11a.

In addressing the *in pari delicto defense*, the court of appeals found that Massachusetts law paralleled federal law as set forth in *Bateman Eichler*. App. at 12a-13a. It

also held that the application of the defense need not be separately analyzed claim by claim because "the analysis ordinarily will be the same across a spectrum of different causes of action," App. at 13a, citations omitted, and any argument that analysis differed claim by claim or between state and federal law had been "waived." App. at 13a.[6]

Having disposed of the preliminaries, the court of appeals proceeded to analyze the applicability of the defense to the Trustee here without regard to the *Bateman Eichler* rule or the parallel state law. Instead, the court emphasized that any claim for Old Dictaphone for fraud committed upon it passed through New Dictaphone before being acquired by the Trustee. The court concluded that

> Because the lineage of the trustee's claims passes directly through New Dictaphone, any right that the trustee may have to assert those claims derives directly from New Dictaphone. . . . The trustee may assert only those claims that New Dictaphone could have asserted prior to seeking the protection of the bankruptcy court.

App at 14a.

The court relied on Bankruptcy Code Section 541, *Mediators, Inc.*, *Edwards*, and *Lafferty* to support its conclusion.

Once having reached that conclusion, the court of appeals completely disregarded the equities and complexities of the case which *Bateman Eichler* and parallel state law required it to consider. Instead, the imputation of guilt to the Trustee effectively resolved

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[6] The Trustee had argued, with citations to authority, that barring the claim was inequitable under both federal and state law.

every other issue and overcame every other equity and policy.

That the Trustee was of equal fault was dictated by the fact that the Trustee was in effect New Dictaphone, and the equities arising from the genesis of the claim or the replacement of Old Dictaphone were disregarded. App. at 16a-22a. The allowance of the defense would not interfere with the purposes of the securities law because the Trustee was guilty (by imputation) and the law is not designed to protect the guilty. App. at 23a.

The court found it "preferable" that the creditors sue individually, rather than through a trustee, because it speculated that L&H "may well" be a beneficiary of the trust. App. at 23a.[7] It noted that the creditors could still sue former directors, controlling shareholders and outside accounting professionals, without noting the serious policy implications of allowing direct participants in fraud to escape liability while holding merely negligent parties to account. *See* App. at 24a.

THE REASONS FOR GRANTING THE WRIT

1. The Question of Whether a Trustee May Be Held "*In Pari Delicto*" on Federal Claims because of his Predecessor's Fault is an Important Issue Left Open by this Court in *Bateman Eichler*, which has Split the Circuits

The language of *Bateman Eichler* allows for no exception. The *in pari delicto* defense may be applied to a suit by a trustee or receiver "*only*" if the two prongs of the *Bateman Eichler* test are met. The courts of appeals have

[7] Any concern on that front should have been resolved by the fact that L&H had been through its own bankruptcy and its creditors, not its guilty principals, would benefit in that event. *See, Baena v. KPMG LLP*, 453 F. 3d 1 (1st Cir. 2005).

discussed whether a trustee or receiver should be considered to be of "substantially equal" guilt. But like the First Circuit below, they have not analyzed that issue addressing the language used or the policies behind the *Bateman Eichler* decision.

The first prong of the *Bateman Eichler* test was framed in a way that suggested only the fault of the litigant appearing before the Court is to be considered. As the this Court held, an *in pari delicto* defense could apply in federal securities fraud cases "where . . . as a *direct result* of his *own* actions" there is "at least substantially equal responsibility" for the violations he seeks to redress." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. at 310-11 (emphasis supplied).

The emphasis by this Court on the "direct result" and the parties' "own actions" would seem to preclude the use of the defense when the parties' liability for wrongful conduct is a result of vicarious liability, principles of agency, or imputation, rather than direct participation in the wrongful conduct alleged. The need to show the plaintiff's direct personal involvement in the wrong was re-emphasized in *Pinter v. Dahl*, 486 U.S. 622 (1988), where this Court held:

> Under the first prong of the *Bateman Eichler* test, as we have noted above, a defendant cannot escape liability unless, as a *direct result of the plaintiff's own actions*, the plaintiff bears at least substantially equal responsibility for the underlying illegality. The *plaintiff must be an active, voluntary participant in the unlawful activity* that is the subject of the suit. *See Woolf v. S. D. Cohn & Co.*, 515 F.2d 591, 604 (CA5 1975), *vacated and remanded on other grounds*, 426 U.S. 944 (1976) . . ."

Id. at 635-636 (emphasis added).

A similar formulation also appears in Justice Harlen's concurrence and dissent in *Perma Life Mufflers v. International Parts Corp.*, 392 U.S. 134 (1968): "Plaintiffs who are truly *in pari delicto* are those *who have themselves violated* the law in cooperation with the defendant." *Id.* at 153. (emphasis supplied).

It is true that these cases did not address the question presented here, whether a trustee who succeeds to the rights of a corporate wrongdoer is considered guilty to the same extent as his predecessor. However, the least that can be said about that issue is that the language of the cases leaves it open to be resolved. That conclusion is buttressed by the fact that the *Bateman Eichler* Court declined to resolve the argument raised by an amicus Securities Industry Association ("SIA") as to whether a liability of a "controlling person" of the defrauding party has a better ground for asserting the defense when the controlling person's liability was only 'vicarious' and 'secondary'." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. at 314.

The circuit court opinions have addressed the issue of the application of *in pari delicto* to trustees or receivers have deeply split. Those courts which have addressed the issues in terms of general equitable principles or specific state law have found that the Trustee is not barred by his predecessor's wrongs. *See, e.g., Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995) ("the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated."); *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) (holding under California law "While a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on . . . [an] innocent entity that steps into the party's shows pursuant to court order or operation of law"); *In re The Personal*

and Business Insurance Agency v. McNamara, 334 F.3d 239 (3d Cir. 2003) (same).

Those courts to have allowed the defense against a Trustee have generally followed a more mechanical approach, concluding that a trustee "steps into the shoes" of his predecessor and has no defenses that the predecessor did not have. Those courts, including the First Circuit below, have relied upon Bankruptcy Code Section 541 as the basis for their assertion and have not tried to reconcile that provision with *Bateman Eichler*. *See*, App. at 14a-15a; *Official Committee of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145 (2006); *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 357 (3d Cir. 2001).

Under the general principles which underlie *Bateman Eichler*, the defense should not be allowed unless the particular equities of the case demand otherwise. Section 541 does not require that the important public policy concern for enforcement of federally-protected rights should be disregarded when a bankruptcy trustee pursues those claims.

A. Under General Equitable Principles and with regard to the Limited Role of *In Pari Delicto* Defense in Federal Claims, a Trustee is Not "of Equal Fault" with the Wrongdoer

The place to begin the analysis is with *Bateman Eichler* itself. It is beyond question that allowing trustees to pursue suits will advance the purposes of enforcement of federal law. That result shall only be thwarted if there are strong reasons to require it. But review of the equitable underpinnings of the rule supports barring the defense, not enforcing it.

As this Court noted in *Bateman Eichler*, the *in pari delicto* defense st[illegible]ds on two grounds: "First, that the

Court should not lend their good offices to mediating disputes among wrongdoers, and second, that denying judicial relief to an admitted wrongdoer is an affective means of deterring illegality." 472 U.S. at 306. Neither of these grounds for the defense is truly implicated when a trustee is suing wrongdoers to obtain assets for creditors of a debtor.

As to the first ground, allowing an innocent Trustee to pursue claims against guilty parties for the benefit of innocent creditors can hardly be said to compromise the integrity of the courts. This Court has recognized the propriety of proceeding on behalf of a receiver even where the receiver's predecessor would have been barred by fraud. In *McCandless v. Furlaud*, 296 U.S. 140 (1935), a suit was initiated by a receiver of an insolvent corporation to compel the corporate promoters, their confederates, to restore property that would be diverted from the corporation as a result of a fraudulent scheme. The corporation shareholders, promoters and directors were all involved. The Court of Appeals had dismissed the receiver's case on the ground that the consent of the shareholders to the fraudulent transaction bound the corporation and the receiver stood in no better position. This Court reversed in an opinion by Justice Cardozo holding:[8]

> There is no occasion to consider whether the corporation itself at the instance of new shareholders would be permitted to disaffirm the fraud and main-

[8] *McCandless* was distinguished by this Court in *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416, 429 (1972). *Caplin* held that under the applicable bankruptcy statutes a bankruptcy trustee was not entitled to pursue causes of action which belong to creditors. In *McCandless*, the Court noted, the receiver was "suing on behalf of the corporation, not third parties." *Id.* The Trustee in this case is likewise suing on behalf of the corporation, Dictaphone, for its own losses.

> tain a suit in equity for appropriate relief. We put that question by. Enough that the receiver has the requisite capacity. *Id.*, at 160-161.

Relying on *McCandless* and general equitable principals, in *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995) Judge Posner explained the reason and the policy behind denying the *in pari delicto* defense when a suit is brought by a receiver or trustee.

> Now that the corporations created and initially controlled by Douglas are controlled by a receiver whose only object is to maximize the value of the corporations for the benefit of their investors and any creditors, we cannot see an objection to the receiver's bringing suit to recover corporate assets unlawfully dissipated by Douglas.

Scholes v. Lehmann, 56 F.3d at 754-755.

Similar conclusions about the equity of allowing trustees or receivers to pursue claims free of the *in pari delicto* defense have been reached by other circuit courts applying general equitable principals. *McNamara v. PFS (In re Personal & Bus. Ins. Agency)*, 334 F.3d at 246 ("as the bad actor, Kesselring, has been eliminated and the trustee comes to us with clean hand, representing the interests of innocent creditors. If the doctrine of imputation were applied to bar PBI's recovery, that application would lead to an inequitable result (loss to innocent creditors)."). *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) ("While a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on . . . [an] innocent entity that steps into the party's shoes pursuant to court order or operation of law.") (applying California law). Similar rulings have been made by state courts applying general equitable principals. *See, e.g. ISP.com,*

LLC v. Theising, 805 N.E.2d 767, 772-773 (Ind. 2004); *Universal Builders, Inc. v. Moon Motor Lodge, Inc.*, 430 Pa. 550 (Pa. 1968); *Albers v. Continental Illinois Bank & Trust Co.*, 296 Ill. App. 596, 599 (Ill. App. Ct. 1938); *Camerer v. California Sav. & Commercial Bank*, 4 Cal. 2d 159, 170 (Cal. 1935).

There is no case of which we are aware which articulates a principled basis for denying the creditors recovery through a trustee or receiver and allowing wrongdoers to escape liability.

In addition, there are practical benefits of allowing such recoveries, as Judge Posner also observed.

> The conceivable alternatives to these suits for getting the money back into the pockets of its rightful owners are a series of individual suits by the investors, which, even if successful, would multiply litigation; a class action by the investors – and class actions are clumsy devices; or, most plausibly, an adversary action, in bankruptcy, brought by the trustee in bankruptcy of the corporations if they were forced into bankruptcy.

Scholes v. Lehmann, 56 F.3d at 755.

For all of these reasons, denying application of the defense to a Trustee furthers the policies behind the *Bateman Eichler* rule.

B. The Trustee Here, Asserting a Claim Originally Held by an Innocent Victim of Fraud, was Not of Equal Fault with Defendants

In addition to the equities of allowing a trustee generally to be free of the burden of the *in pari delicto* defense, there is a further reason to deny the defense here because the wrongdoer, New Dictaphone, only acquired the claim for fraud on Old Dictaphone as a

result of the success of the wrongful merger. Because of the merger, the creditors of Old Dictaphone, became creditors of New Dictaphone. *See* Del. G.C.L. § 259.

In effect, the merger was a fraud on the creditors of Old Dictaphone and it destroyed the entire enterprise value of the entity the creditors were entitled to look to for recovery. Where the Trustee is seeking to obtain recompense from the participants in the fraud for the benefit of creditors who were the target of the fraud, barring that action is particularly inequitable.

C. Bankruptcy Code § 541 Neither Prohibits Consideration of Equities Presented by a Trustee Suit Nor Trumps this Court's *Bateman Eichler* Test in Determining the Proper Application of *In Pari Delicto*

The First Circuit below and the other circuits applying *in pari delicto* to defeat federal law based claims asserted by a bankruptcy trustee rely on their reading of Bankruptcy Code Section 541. As the Eleventh Circuit stated in *Edwards*, in language which best articulates the argument:

> Under the plain meaning of section 541(a), the debtor estate includes all "legal or equitable interests of the debtor as of the commencement of the case." 11 U.S.C. § 541(a) *(emphasis added)*. "A bankruptcy trustee stands in the shoes of the debtor and has standing to bring any suit that the debtor could have instituted" when the debtor filed for bankruptcy, and there is no suggestion in the text of the Bankruptcy Code that the trustee acquires rights and interests greater than those of the debtor. *O'Halloran*, 350 F.3d at 1202; see also 11 U.S.C. § 362(a). If a claim of ETS would have been subject to the defense of *in pari delicto* at the commence-

> ment of the bankruptcy, then the same claim, when asserted by the trustee, is subject to the same affirmative defense.

Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d at 1150.

However, the argument has been expressly rejected by numerous commentators[9] and at least one Bankruptcy court,[10] and is unsound for several reasons. First, Section 541 does not address the rights of trustees or the application of defenses at all, it merely identifies what is "property of the debtor." 11 U.S.C. § 541(a). Nothing in that section would seem to place any restriction on the discretion of a court of equity to apply equitable defenses in a manner which was equitable. Indeed, the discretion of the court in applying equitable defenses was a settled law at the time the section was enacted. *See, Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240, 245-246 (1933) ("courts of equity do not make the quality of suitors the test. They are not bound by formula or restrained by any limitation that tends to trammel the free and just exercise of discretion."); 1 Story, Commentaries on Equity Jurisprudence § 423, at 399-

[9] *See* Jeffrey Davis, *Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing to Do with What is § 541 Property of the Bankruptcy Estate*, 21 Emory Bankr. Dv. J. 519 (Summer 2005); Tanvir Alalm, *Fraudulent Advisors Exploit Confusion in the Bankruptcy Code: How In Pari Delicto Has Been Perverted to Prevent Recovery for Innocent Creditors*, 77 Am Bannkr. L.J. 305 (Summer 2003); Gerald L. Baldwin, *In Pari Delicto Should Not Bar a Trustee's Recovery*, 23 Am. Bankr. Inst. J. 8 (Oct. 2004); *Making Sense of the In Pari Delicto Defense: "Who's Zoomin' Who?"* 23 No. 11 Bankr. Law Letter 1 (Nov. 2003); Robert T. Kugler, *The Role of Imputation and In Pari Delicto in Barring Claims Against Third Parties*, 1 No. 14 Andrews Bankr. Lit. Rep. 13 (2004).

[10] *Talz v. Proskauer Rose LLP (In re Fuzion Tech. Group, Inc.)*, 332 B.R. 225 (S.D. Fla 2005).

400 (14th ed. 1918); Pomeroy's Equity Jurisprudence, 4th Ed., Section 941, pp. 1998-9. There is no reason to believe that in enacting the section Congress intended to change that settled law.

Second, the defense of *in pari delicto* is one which is historically based on personal fault. The legislative history of the Section 541 expressly states that defenses that are "personal against the debtor" are *not* effective against the estate:

> Thus, as section 541(a)(1) clearly states, the estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case. To the extent such an interest is limited in the hands of the debtor, it is equally limited in the hands of the estate *except to the extent that defenses are personal against the estate.*

11 U.S.C.A § 541 note (West 2004) Legislative Statements (emphasis added); 124 Cong. Rec. 32,399 (1978). *See, also,* 5 Collier on Bankruptcy ¶ 541.04 (15th rev. ed. 2004) ("To the extent an interest is limited in the hands of the debtor, it is equally limited as property of the estate *except to the extent that defenses which are personal against the debtor are not effective against the estate."* (emphasis added)); Jeffrey Davis, *Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing to Do with What is § 541 Property of the Bankruptcy Estate,* 21 Emory Bankr. Dev. J. 519, 538-39 (Summer 2005) (same). *See also In re Fuzion Tech.,* 332 B.R. at 231-232 (same).

Third, finding that the Trustee is not barred by *in pari delicto* is consistent with by the rule of "absolute priority" embodied in the Bankruptcy Act and underlying much of

American jurisprudence.[11] Under "absolute priority" rule, where there is a business failure, creditors should recover prior to equity holders. The rule is abandoned by denying a Trustee the right to pursue such claims, but allowing shareholders to proceed unencumbered by the defense.

Fourth, and most importantly, there is nothing in Section 541 which would allow it to override the *Bateman Eichler* rule in cases brought by bankruptcy trustees. Were this Court to allow the broad interpretation of Section 541 to prevail, than *Bateman Eichler* would become largely irrelevant, applicable only in the exceptional cases where the defense is raised outside the bankruptcy context.

[11] The principles that creditors are paid in full before equity recovers any return, known as the "absolute priority" rule, has roots going back to *Northern Pacific R. Co. v. Boyd*, 228 U.S. 482 (1913) and has repeatedly been re-affirmed since. To allow equity holders to elevate their claims through the back door of direct actions would defeat the "absolute priority" rule, which underlies both bankruptcy practice and much of American business law. *Warren*, Bankruptcy Policy, 54 U. Chi. L. Rev. 775, 792 (1987) ("An almost axiomatic principle of business law is that, because equity owners stand to gain the most when a business succeeds, they should absorb the costs of the business's collapse—up to the full amount of their investment."). *See also Consol. Rock Prods. Co. v. Du bois*, 312 U.S. 510, 520-21 (1941) ("stockholders seeking to recover their investments cannot be paid before provable claims have been satisfied in full"); *Slain & Kripke, The Interface between Securities Regulation and Bankruptcy —Allocating the Risk of Illegal Securities Issuance Between Securities Holders and the Issuer's Creditors*, 48 N.Y.U.L. Rev. 261 (1973) (hereinafter "Slain/Kripke").

Accordingly, Section 510(b) of the Bankruptcy Code was enacted to subordinate any claim for damages "arising from the purchase or sale" of the securities of the debtor. That section was adopted as part of the 1978 enactment of the Bankruptcy Code to prevent "disappointed shareholders from recovering their investment loss by using fraud and other securities claims to bootstrap their way to parity with general unsecured creditors in a bankruptcy proceeding." *In re Telegroup, Inc. v. Telegroup, Inc.*, 281 F.3d 133, 142 (3d Cir. 2002).

2. Allowing *In Pari Delicto* to Defeat Claims of Defrauded Merger Targets Substantially Interferes with the Policies of the Federal Securities Law

The First Circuit's fixed focus on the Trustee as a wrongdoer by imputation also caused the court of appeals to misapply the second prong of the Bateman Eichler test. The First Circuit held:

> As we have pointed out, the trustee is not bringing claims on behalf of an innocent target of the fraud but, rather, on behalf of a complicit party. Viewed in that light, the trustee's policy concerns ring hollow. *See Edwards*, 437 F.3d at 1155 (finding public policy exception inapplicable in analogous circumstances) . . . To permit the trustee to proceed in these circumstances would be equivalent to giving New Dictaphone a second bite at the cherry, allowing it first to reap the benefits of the fraud and then to attack the defrauders.

App. at 23a, footnote omitted.

A similar approach was taken by the Eleventh Circuit in *Edwards* to bar a suit by a Trustee under RICO. *Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d at 1155.

It is, of course true, that, as the First Circuit held, that "[t]he securities laws were enacted to protect investors from deceptive practices, see *Pinter*, 486 U.S. at 638, not to give the intended beneficiaries of deceptive practices a back-door means of ensuring a profit." App. at 23a. Yet, if the second prong of the *Bateman Eichler* were readily avoided by simply labeling the plaintiff a wrongdoer, there would be no case where the court could find that the plaintiff was "equally" culpable under *Bateman Eichler's* prong one, yet application of the defense

could nonetheless be barred under prong two on the ground that it "interfere[d] with the effective enforcement of the securities laws."

As this Court has noted, "labels, as often is the case, merely state the conclusion reached, but do not aid in solution of the problem. The ultimate issue is whether the result in the particular case would effectuate or frustrate the purposes of the [Securities] Act." 312 U.S., at 44, n. 2. *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. at 311, n. 20, *citing A. C. Frost & Co. v. Coeur D'Alene Mines Corp.*, 312 U.S. 38, 43 (1941)

Indeed, an argument that the First and Eleventh Circuits rely on was raised and rejected by this Court in *Pinter v. Dahl*, 486 U.S. 622, 637 (1988). As the Court there held, the "broad policies" of the securities laws are

> "protection of investors as a group, not as individuals, and the need for a healthy economy constantly purged by full disclosure. *See, e. g., SEC v. North American Research & Development Corp.*, 280 F. Supp. 106, 121 (SDNY 1968) (purpose of § 5 is to protect public investors through disclosure), *aff'd* in part and vacated in part on other grounds, 424 F.2d 63 (CA2 1970).

Id. at 637, n. 14.

Allowing a relatively culpable party to recover may therefore be allowed when that approach serves to protect "the unknowing and innocent investor." *See, id.* at 637. As this Court held in *Perma Life Mufflers v. International Parts Corp.*, 392 U.S. 134 (1968):

> The plaintiff who reaps the reward of treble damages may be no less morally reprehensible than the defendant, but the law encourages his suit to further the overriding public policy in favor of competition. A more fastidious regard for the relative moral

> worth of the parties would only result in seriously undermining the usefulness of the private action as a bulwark of anti-trust enforcement.

Id. at 139.

Such an approach would seem to be particularly appropriate in this case where the "guilt" of the Trustee is only by imputation, and the claim was acquired by the "guilty" entity only because of the success of the fraud.

Applying the more searching analysis required by *Bateman Eichler* and *Pinter* makes it clear that denying recovery in this case would dramatically interfere with the purposes of the securities laws under which the Trustee seeks to recover. Here, Old Dictaphone was the target of a fraud designed to cause the corporation to surrender its business and assets for consideration that was essentially worthless. Since the object of the fraud was the acquisition of Old Dictaphone by L&H through its subsidiary "New Dictaphone," by definition, the fraud only could succeed if, as occurred here, Old Dictaphone and its fraud claim were acquired by New Dictaphone. If the fact of that acquisition *by itself* is sufficient to bar even an innocent successor Trustee from pursuing claims against the participants in the fraud, than fraud by an acquirer against a merger target would always, *a fortiori*, be insulated from damage claims.

It is hard to see how protecting perpetrators of fraud from the consequences of their actions would not interfere the purposes of the securities laws, for "full disclosure." By contrast, allowing suits, such as the suit by the Trustee in this case, provides a strong incentive to disclosure, which advances the purposes of the securities laws. Such a rule serves to protect innocent investors in other cases and to deter, rather than encourage, fraud in connection with the merger transactions.

3. Allowing Bankruptcy Code Section 541 to Federalize the Application of State Law Claims of *In Pari Delicto* Violates this Court's Holding in *O'Melveny & Myers v. FDIC* and is also an Important Issue Meriting Review by this Court .

The effect of the approach adopted by the First Circuit in this case and by the *Lafferty* and *Edwards* courts does not merely interfere with the Federal policies on application of the *in pari delicto* defense, it also overrides state *in pari delicto* law in a manner which is in direct conflict with this Court's decision in *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994).

In *O'Melveny*, the FDIC as a receiver for a failed bank brought suit against the bank's attorneys for negligence and breach of fiduciary duty arising out of the attorneys' failure to discover the bank's fraudulent conduct. The district court dismissed based on the imputation of the bank's knowledge to the receiver, but the 9th Circuit reversed holding that finding "federal pre-emption not over the law of imputation generally, but only over its application to the FDIC suing as receiver." *Id.* at 85. The 9th Circuit held the receiver was not barred from proceeding with claims that the bank could not itself assert.

This Court reversed finding that the creation of federal law of imputation was inappropriate, and the rules regarding whether receivers could or could not sue where their predecessor corporation was barred from suit must be decided as a matter of state law. *Id.* at 87-88.

Justice Stevens concurred, joined by Justices Blackmun, O'Conner and Souter, to emphasize that "[i]t would be entirely proper for a state court of general jurisdiction to fashion a rule of agency law that would protect creditors of an insolvent corporation from the consequences of wrongdoing by corporate officers even

if the corporation itself, or its shareholders, would be bound by the acts of its agents. *Id.* at 90.

Justice Stevens' concurrence also noted that where the state law is unclear "federal judges must do their best to estimate how the relevant state courts would perform their lawmaking task." *Id.*

On remand, the 9th Circuit adhered to its prior ruling as a matter of state law. *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995).

While the First Circuit below did rely on state law of imputation to determine whether "New Dictaphone" would be held to be "of equal fault," on the determinative issue of whether *the Trustee* was barred by *in pari delicto* if the defense was applicable to New Dictaphone, the court of appeals ignored state law entirely. Instead, citing only Federal law, Bankruptcy Code Section 541, and Federal Cases, the court of appeals held that "the trustee may assert only those claims that New Dictaphone could have asserted prior to seeking the protection of the bankruptcy court." App. at 14a.

The reasoning, however, is flawed. There is no more basis for a federal rule of Trustee standing in this case than there was in *O'Melveny*. Bankruptcy Code Section 541 does not address the standing of a Bankruptcy Trustee (let alone a Litigation Trustee like plaintiff). Instead it merely identifies property of the Estate.[12]

While the First Circuit and the cases on which it relies interpret the language of Section 541 broadly to create

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[12] § 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title [11 USCS § 301, 302, or 303] creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held: (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

federal law regarding defenses available against a bankruptcy trustee, this court was faced with similar language in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. 101-73, 103 Stat. 183, which established the right of the FDIC as receiver in *O'Melveny*.[13] Yet, in *O'Melveny*, FIRREA did not compel a federal rule of law denying the FDIC receiver the right to pursue claims barred as to its predecessor. For the same reasons, Section 541 does not establish a federal rule denying bankruptcy trustees the right to pursue claims which might be denied to the debtor itself.

While this Court will leave the resolution of the state law issue to the court of appeals on remand, there is good reason to believe that under general equitable principles, the Massachusetts courts would allow the Trustee in this case to pursue the wrongdoers free of the *in pari delicto* defense. *See, Choquette v. Isacoff*, 836 N.E.2d 329, 332-333 (Mass. App. Ct. 2005). Here, at the time the claim arose, it was the claim of the innocent victim, Dictaphone. It only briefly passed through the hands of "New Dictaphone. Massachusetts law does recognize limitations on the defense based on the equities of the case. It could well be determined that Massachusetts law would bar the defense of *in pari delicto* against the Trustee under these facts.

Similarly, the other cases to have likewise applied Section 541 to federalize the issue of defenses available against the Trustee have done so without attempting to analyze conflicting state law on the issue. *Compare,*

[13] Section 1821(d)(2)(A)(i), which is part of a title captioned "Powers and duties of [the FDIC] as . . . receiver," states that HN4"the [FDIC] shall, . . . by operation of law, succeed to—all rights, titles, powers, and privileges of the insured depository institution . . . ." 12 U.S.C. § 1821(d)(2)(A)(i) (1988 ed., Supp. IV). *O'Melveny & Myers v. FDIC*, 512 U.S. at 86.

Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 356 (3d Cir. 2001) (applying *in pari delicto* to Pennsylvania law claim by Creditors Committee), with *Universal Builders, Inc. v. Moon Motor Lodge, Inc.*, 430 Pa. 550 (Pa. 1968) (holding under Pennsylvania law that *in pari delicto* defense should not be applied to deny a plaintiff bankruptcy trustee recovery); *Adelphia Communs. Corp. v. Bank of Am. (In re Adelphia Communs. Corp.)*, 330 B.R. 364, 381 (Bankr. D.N.Y. 2005) (same); *Waslow v Grant Thornton LLP (In re Jack Greenberg, Inc.)*, 240 B.R. 486 (Bankr. E.D. Pa. 1999) (Sigmund, J.) ("Jack Greenberg") (rejecting *in pari delicto* defense in action brought against accountants by chapter 7 trustee) and *Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145, 1151 (11th Cir. 2006) ("the defense of *in pari delicto* may be asserted against a bankruptcy trustee") with *Brooke v. Kennedy*, 172 Ga. 461, 463-464 (Ga. 1931) (rejecting the defense against a receiver "These contracts were assets which came into the hands of the receiver, and from which creditors should be paid. It would require a strong case for a court of equity under such circumstances to refuse the creditors protection through a receiver . . .").

Equally pernicious, the federalization of defenses to state law causes of action by a Trustee has distorted the application of the defense of *in pari delicto* in state courts as well. *See, Peregrine Funding, Inc. v. Sheppard Mullin Richter & Hampton LLP*, 133 Cal. App. 4th 658, 680 (Cal. Ct. App. 2005) (applying *in pari delicto* defense to claims of bankruptcy trustee on the basis of federal cases construing Section 541.)

Section 541 should not be used to federalize state law of imputation in cases where state law governs the defense. For this reason as well, this case merits review by this Court.

CONCLUSION

For all of the above reasons, each of which is independently sufficient, petitioner respectfully requests that this Court issue a writ of certiorari.

Dated: New York, New York
February 22, 2007

Respectfully Submitted,

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UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 05-1774
November 8, 2006, Decided

ALAN NISSELSON, TRUSTEE OF THE DICTAPHONE LITIGATION TRUST,

Plaintiff-Appellant,

—v.—

JO LERNOUT *et al.*,

Defendants-Appellees.

Max Folkenflik and Regina Griffin, with whom Folkenflik & McGerity, Brauner Baron Rosenzweig & Klein, Karen D. Hurvitz, and Law Offices of Karen D. Hurvitz were on brief, for appellant.

George A. Zimmerman, with whom Matthew J. Matule and Skadden, Arps, Slate, Meagher & Flom LLP were on brief, for appellee SG Cowen and Company, LLC.

Janet B. Fierman, with whom Thomas W. Evans, Robert M. Cohen, and Cohen & Fierman, LLP were on brief, for appellee Mercator Assurances, S.A.

Robert J. Kaler, with whom Eric Neyman and Gadsby Hannah LLP were on brief, for appellees Flanders Language Valley Fund et al.

Michael P. Carroll, with whom Michael S. Flynn, Sean C. Knowles, Phineas E. Leahey, Davis Polk & Wardwell, Kevin J. Lesinski, William J. Hanlon, Kristin G. McGurn, and Seyfarth Shaw LLP were on brief, for appellee KPMG LLP.

Thomas J. Gallitano, Conn, Kavanagh, Rosenthal Peisch & Ford LLP, John B. Missing, Ada Fernandez Johnson, and Debevoise & Plimpton LLP on brief for appellee GIMV, N.V.

Michael J. Stone, Peabody & Arnold LLP, George A. Salter, Nicholas W.C. Corson, and Hogan & Hartson LLP on brief for appellee Klynveld Peat Marwick Goerdeler Bedrijfsrevisoren.

Robert P. Trout, John Thorpe Richards, Jr. and Trout Cacheris, PLLC on brief for appellee Lessius Management Consulting, N.V.

Andrew Good, Good & Cormier, Roger E. Zuckerman, Steven M. Salky, P. Andrew Torrez, and Zuckerman Spaeder LLP on brief for appellee Louis-H. Verbeke.

Before Selya, Lipez and Howard, Circuit Judges.

OPINION:

SELYA, Circuit Judge.

This appeal requires us to explore an arcane corner of the world of corporate finance. In the underlying series of events, a corporate shark, using fraudulent means, induced an allegedly innocent target corporation to enter into an ill-advised merger. After both the shark and the merged entity drowned in red ink, plaintiff-appellant Alan Nisselson (the trustee), appointed by the bankruptcy court to prosecute any causes of action that the merged entity might possess, attempted to mount various claims arising out of the innocent target's legal rights. Those rights, of course, were twice removed from the damages that formed the basis of the suit: they were passed along once to the surviving corporation (at the time of the merger) and again to the trustee (during the bankruptcy proceedings).

Emphasizing this genealogy, the district court dismissed the action on two grounds; it determined that the trustee lacked standing to pursue the claims and that, in all events, the rascality of the shark was as a matter of law imputed to the surviving entity in the merger (and that, therefore, the hoary in pari delicto doctrine barred the suit). See *Nisselson v. Lernout, No. 03-10843, 2004 U.S. Dist. LEXIS 28655, at *20-21 (D. Mass. Aug. 9, 2004)*. Concluding, as we do, that the second of these determinations withstands scrutiny—the trustee's claims are incurably tainted because they derive from the itself-complicit surviving corporation—we affirm the judgment below.

I. BACKGROUND

We glean the pertinent facts from the amended complaint, supplementing those facts as needed by docu-

ments fairly incorporated therein and matters susceptible to judicial notice. See *Centro Medico del Turabo, Inc. v. Feliciano de Melecio*, 406 F.3d 1, 5 (1st Cir. 2005); *In re Colonial Mortg. Bankers Corp.*, 324 F.3d 12, 15-16 (1st Cir. 2003). While the scheme that lies at the center of this case comprises a complex tale of sophisticated financial chicanery, we rehearse here only those features essential to an understanding of the present proceeding. We urge the reader who thirsts for greater knowledge to consult the array of published opinions emanating from related litigation. See, e.g., *Baena v. KPMG LLP*, 453 F.3d 1 (1st Cir. 2006); *Quaak v. Klynveld Peat Marwick Goerdeler Bedrijfsrevisoren*, 361 F.3d 11 (1st Cir. 2004); *Bamberg v. SG Cowen*, 236 F. Supp. 2d 79 (D. Mass. 2002); *Filler v. Lernout*, 230 F. Supp. 2d 152 (D. Mass. 2002); *In re Lernout & Hauspie Sec. Litig.*, 208 F. Supp. 2d 74 (D. Mass. 2002).

By the time the new millennium dawned, Dictaphone Corporation (Old Dictaphone), a company chartered under the laws of Delaware, had established itself as a force in the healthcare speech and language applications market. Lernout & Hauspie, N.V. (L&H), a Belgian corporation that ran its United States operations from headquarters in Massachusetts, was itself an international leader in various speech and language sectors. In hopes of swallowing up its competitor, L&H began courting Old Dictaphone; it described in glowing terms its financial stability and the profitable synergies that a merger could generate. Negotiations ensued.

Not surprisingly, Old Dictaphone conducted extensive due diligence investigations into L&H's fiscal health. During the course of that review, L&H's senior officers, investment bankers, attorneys, and auditors touted its financial prowess. Against this rose-colored backdrop, Old Dictaphone agreed to a stock-for-stock merger. The

parties memorialized the terms in a merger agreement dated March 7, 2000.

The merger took place less than two months thereafter: L&H acquired all the outstanding stock of Old Dictaphone in exchange for approximately 9,400,000 shares of L&H common stock. Based on the trading price of L&H stock at the time of the closing, the exchange corresponded to a merger price of roughly $930,000,000.

As part and parcel of the transaction, Old Dictaphone merged into Dark Acquisition Corp. (Dark), a wholly-owned subsidiary of L&H created under Delaware law for the express purpose of effectuating the merger. L&H's chief executive officer, defendant-appellee Gaston Bastiaens, doubled in brass as Dark's chief executive and lone director. He also signed the merger agreement on its behalf.

Under the terms of the merger agreement, Dark inherited Old Dictaphone's assets (including any existing legal claims) and assumed Old Dictaphone's liabilities. This arrangement corresponded to the dictates of Delaware law. See *Del. Code Ann. tit. 8, § 259(a)*. Dark survived the merger and Old Dictaphone ceased to exist. Dark then changed its name to Dictaphone Corporation (New Dictaphone).

The honeymoon was brief. Shortly after the merger had been consummated, L&H announced that the financial picture it had painted and displayed was not an accurate portrayal. As matters turned out, nearly two-thirds of L&H's reported revenue from 1998 through mid-2000 had been improperly recorded, so that an apparent $ 70,000,000 net profit for that period was in fact a net loss of a similar magnitude. The price of L&H shares plummeted and, on November 29, 2000, L&H and

New Dictaphone filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code.

We fast-forward to New Dictaphone's approved plan of reorganization. As part of that plan, the corporation conveyed its interest in any claims arising out of the merger to the Dictaphone Litigation Trust (the Trust). That assignment galvanized this suit: acting on behalf of the Trust, the trustee filed a civil action in federal district court seeking damages to compensate for the "loss or diminution of [Old Dictaphone's] value as a going concern."

The trustee's amended complaint characterizes the gross misstatments of earnings as the mainspring of a fraudulent scheme designed to inflate the value of L&H's stock. As the trustee envisions it, this scheme, which played out over a four-year period, was concocted and executed by the defendants in this case (who include the officers, directors, investment bankers, attorneys, and auditors of L&H, and divers entities related to them). The fallout from it rendered worthless the consideration that Old Dictaphone and its shareholders received (assumption of Old Dictaphone's debt and shares of L&H stock).

In his amended complaint, the trustee asserts federal securities and racketeering claims, see *15 U.S.C. §§ 78j(b), 78t(a); 18 U.S.C. § 1962(c); 17 C.F.R. § 240.10b-5*, as well as supplemental state-law claims for fraud, unfair trade practices, negligent misrepresentation, and conspiracy. The theory underlying each and all of these initiatives is that L&H, through its senior management, knowingly engaged in a scheme to classify research and development expenditures as fictional revenue in order to inflate the value of the company's stock. Then, knowing that they were selling a lie, L&H's hierarchs flaunted the company's ever-increasing stock price and used its apoc-

ryphal earnings to persuade Old Dictaphone and its shareholders to enter into a stock-for-stock merger. L&H relied on its investment bankers, attorneys, accountants, and related entities to substantiate its false claims; those parties, the trustee contends, knew that L&H was spinning a yarn, yet assisted it in perpetrating the fraud.[1]

Various defendants, led by SG Cowen (an investment banking house), filed motions to dismiss. See *Fed. R. Civ. P. 12(b)(6)*. All of these motions argued, in relevant part, that the trustee lacked standing and that his claims were barred under the in pari delicto doctrine. Some of the motions advanced additional grounds for dismissing particular claims. The trustee vigorously opposed the motions.

In due course, the district court granted Cowen's motion and dismissed the trustee's federal claims against Cowen with prejudice. See *Nisselson, 2004 U.S. Dist. LEXIS 28655, at *20-21*. The court rested its decision on two alternative grounds. First, it concluded that the in pari delicto doctrine barred the claims because the trustee had inherited them from New Dictaphone, an entity itself implicated in the alleged fraud. See *2004 U.S. Dist. LEXIS 28655, at *12-15*. Second, interpreting and applying the Delaware standard for distinguishing direct and derivative claims, it concluded that the trustee lacked standing because the claims asserted belonged to

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[1] This suit comprised one of many filed in the wake of L&H's revenue restatement. In one such related action, Stonington Partners, Inc., which had owned ninety-six percent of Old Dictaphone prior to the merger, sued for damages allegedly incurred when it traded its once-valuable interest for what ended up being worthless paper.

For his part, the trustee has brought separate actions for breach of fiduciary duty against Old Dictaphone's former directors and controlling shareholders and for breach of contract and negligence against the accountants and investment bankers who counseled Old Dictaphone during the merger negotiations.

Old Dictaphone's former shareholders, not to Old Dictaphone itself. See *2004 U.S. Dist. LEXIS 28655, at *15-20* (discussing, inter alia, *Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1033 (Del. 2004)*). For the same reasons, the court, in a series of subsequent orders, granted the other appellees' motions to dismiss.[2] This timely appeal followed.

II. ANALYSIS

We review *Rule 12(b)(6)* dismissal orders de novo, assuming the truth of all well-pleaded facts contained in the operative version of the complaint and indulging all reasonable inferences in the plaintiff's favor. See *McCloskey v. Mueller, 446 F.3d 262, 266 (1st Cir. 2006)*. Facts distilled in that fashion may be augmented by reference to (i) documents annexed to it or fairly incorporated into it, and (ii) matters susceptible to judicial notice. See *Centro Medico del Turabo, 406 F.3d at 5*; *Rodi v. S. New Eng. Sch. of Law, 389 F.3d 5, 12 (1st Cir. 2004)*. Where, as here, a district court rests its decision on alternative grounds, an appellate court need not explore both; if it determines that one such ground fully supports the order of dismissal, the court may end its deliberations at that point. See *Feinstein v. Resolution Trust Corp., 942 F.2d 34, 41 n.7 (1st Cir. 1991)*.

This case presents an idiosyncratic procedural feature. While most *Rule 12(b)(6)* motions are premised on a plaintiff's putative failure to state an actionable claim, such a motion may sometimes be premised on the inevitable success of an affirmative defense. See, e.g., *In re Colonial Mortg. Bankers, 324 F.3d at 16*; *Blackstone Realty v. FDIC, 244 F.3d 193, 197 (1st Cir. 2001)*; *Keene*

[2] The lower court did not reach any of the additional arguments proffered by the defendants, nor do we.

Lumber Co. v. Leventhal, 165 F.2d 815, 820 (1st Cir. 1948). Dismissing a case under *Rule 12(b)(6)* on the basis of an affirmative defense requires that "(i) the facts establishing the defense are definitively ascertainable from the complaint and the other allowable sources of information, and (ii) those facts suffice to establish the affirmative defense with certitude." *Rodi, 389 F.3d at 12.*

A. Standing.

The district court characterized both the in pari delicto doctrine and the absence of cognizable injury as evincing a lack of standing. See *Nisselson, 2004 U.S. Dist. LEXIS 28655, at *12-13*. Part of this characterization is inapt: the in pari delicto doctrine does not implicate a plaintiff's standing to sue but, rather, constitutes an affirmative defense. See *Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d 1145, 1149-50 (11th Cir. 2006)*; *Official Comm. of Unsecured Creditors of Color Tile, Inc. v. Coopers & Lybrand, LLP, 322 F.3d 147, 157 (2d Cir. 2003)*; see also *Baena, 453 F.3d at 6* (noting that the doctrine is, on occasion, "dubiously" referred to as implicating standing).

This does not mean, however, that we must grapple with the district court's alternative "distinct injury" holding first. Even though challenges to a plaintiff's standing are often considered threshold issues in federal cases, see, e.g., *Pagan v. Calderon, 448 F.3d 16, 26 (1st Cir. 2006)*; *Eulitt v. Me. Dep't of Educ., 386 F.3d 344, 351 (1st Cir. 2004)*, such challenges must be addressed first only if they call into question a federal court's Article III power to hear the case. See *Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 94-95, 118 S. Ct. 1003, 140 L. Ed. 2d 210 (1998)*. The constitutional prerequisites for Article III standing are satisfied so long as a plaintiff colorably alleges an actual injury that is both

traceable to the defendant's conduct and redressable by a favorable decision. See *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-62, 112 S. Ct. 2130, 119 L. Ed. 2d 351 (1992); *Ramirez v. Sanchez Ramos*, 438 F.3d 92, 97 (1st Cir. 2006).

In this case, those prerequisites have been fulfilled. For purposes of their motions to dismiss, the defendants wisely choose not to contest the trustee's assertion that the conduct attributed to them resulted in a redressable injury; instead, they posit that the trustee is seeking to prosecute claims that, although cognizable in a federal court, belong exclusively to Old Dictaphone's former shareholders. The determination of who may maintain an otherwise cognizable claim turns on a question of prudential standing, not one of Article III standing. See *Baena*, 453 F.3d at 5; see also *Ramirez*, 438 F.3d at 98.

That frees our hands: Steel Co.'s ban on hypothetical jurisdiction extends only to issues involving Article III jurisdiction and, hence, Article III standing. There is no counterpart rule that demands the resolution of objections based on prudential concerns before other issues can be adjudicated. See *Baena*, 453 F.3d at 5; *McBee v. Delica Co.*, 417 F.3d 107, 127 (1st Cir. 2005).

Mandatory rules aside, courts should not rush to rely on hypothetical jurisdiction. See *Berner v. Delahanty*, 129 F.3d 20, 23 (1st Cir. 1997). Nevertheless, one situation in which hypothetical jurisdiction, if otherwise proper, may be invoked is when doing so would avoid the need to sort out thorny jurisdictional tangles. See, e.g., *McBee*, 417 F.3d at 127; *Parella v. Ret. Bd. of R.I. Employees' Ret. Sys.*, 173 F.3d 46, 56 (1st Cir. 1999). As we explain briefly, just such a tangle exists here.

Although the decision in Tooley may have helped to clarify the often elusive distinction between direct and derivative claims, that distinction remains tenebrous. See

Richard Montgomery Donaldson, Mapping Delaware's Elusive Divide: Clarification and Further Movement Toward a Merits-Based Analysis for Distinguishing Derivative and Direct Claims in Agostino v. Hick and Tooley v. Donaldson, Lufkin & Jenrette, Inc., *30 Del. J. Corp. L. 389, 404 (2005)* (listing the "determination of who suffered the harm—the corporation or the shareholder(s)" as one of the potentially confusing issues left open under Tooley). More to the point, it is not immediately apparent how the Delaware court's newly announced two-part test, *845 A.2d at 1033*, should apply to the unique facts of this stock-for-stock merger. Because the record reflects a clear and sufficient basis apart from standing for affirming the district court's judgment, we bypass these uncharted waters.

B. The In Pari Delicto Doctrine.

In pari delicto is both an affirmative defense and an equitable defense. Broadly speaking, the defense prohibits plaintiffs from recovering damages resulting from their own wrongdoing. See *Terlecky v. Hurd (In re Dublin Sec.), 133 F.3d 377, 380 (6th Cir. 1997)*. The label derives from the Latin phrase in pari delicto potior est conditio possidentis, which admonishes that "[i]n a case of equal or mutual fault . . . the condition of the [defending party] is the better one." Black's Law Dictionary 791 (6th ed. 1990).

The doctrine is grounded on twin premises. The first is that "courts should not lend their good offices to mediating disputes among wrongdoers." *Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306, 105 S. Ct. 2622, 86 L. Ed. 2d 215 (1985)*. The second is that "denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality." Id.

The in pari delicto defense has long been woven into the fabric of federal law. See *id. at 307* (discussing the doctrine's historical development); see also *Fleming v. Lind-Waldock & Co., 922 F.2d 20, 28 (1st Cir. 1990)*; *Duncan v. Maine C. R. Co., 113 F. 508, 509 (C.C.D. Me. 1902)*. It does not make a difference that some of the trustee's claims are premised on state law. Those claims invoke the law of Massachusetts—and the Massachusetts courts, like the federal courts, have warmly embraced the in pari delicto defense. See, e.g., *Council v. Cohen, 303 Mass. 348, 21 N.E.2d 967, 970 (Mass. 1939)*; *Choquette v. Isacoff, 65 Mass. App. Ct. 1, 836 N.E.2d 329, 332 (Mass. App. Ct. 2005)*.

As originally conceived, the in pari delicto doctrine forged a defense of limited utility. Over time, however, courts expanded the doctrine's sweep, deploying it as a basis for dismissing suits whenever a plaintiff had played any role—no matter how modest—in the harm-producing activity. See *Bateman Eichler, 472 U.S. at 307*. Deploring this overly commodious construction, the Supreme Court later reined in the doctrine and returned it to its classic contours. See *Pinter v. Dahl, 486 U.S. 622, 635, 108 S. Ct. 2063, 100 L. Ed. 2d 658 (1988)*; *Bateman Eichler, 472 U.S. at 310-11*. This retrenchment, which governs here, restricts the application of the in pari delicto doctrine to those situations in which (i) the plaintiff, as compared to the defendant, bears at least substantially equal responsibility for the wrong he seeks to redress and (ii) preclusion of the suit would not interfere with the purposes of the underlying law or otherwise contravene the public interest. See *Bateman Eichler, 472 U.S. at 311* (discussing the doctrine's application to federal securities laws); see also *Edwards, 437 F.3d at 1154*. Recent Massachusetts case law mirrors

these refinements. See, e.g., *Choquette, 836 N.E.2d at 332-33.*

While the application of this binary paradigm may vary slightly depending on the nature of the particular claim asserted, courts nonetheless speak of a single doctrine. This is because the analysis ordinarily will be the same across a spectrum of different causes of action. See *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 345-46 (3d Cir. 2001)*; see also *Coopers & Lybrand, 322 F.3d at 160.*

The court below adopted this one-size-fits-all approach in addressing the in pari delicto defense; it neither distinguished among the various counts nor differentiated between federal and state law. The trustee has not objected to this approach, so he has waived any argument either that a claim-by-claim analysis is obligatory or that some material differences exist between applicable federal and state law. See *Domegan v. Fair, 859 F.2d 1059, 1065 (1st Cir. 1988)* ("It is too familiar to warrant string citation that we will not consider arguments which could have been, but were not, advanced below."). Consequently, we employ the same generic strain of the in pari delicto doctrine throughout our review.

C. Establishing the Appropriate Benchmark.

To apply the requisite two-part paradigm in the circumstances of this case, we must answer a threshold question: Who, exactly, are the proper parties for the purpose of determining relative blame? The trustee's answer to this query is straightforward. Because his claims originate with Old Dictaphone, he asseverates that this indisputably innocent party is the relevant entity for purposes of the comparison required by the binary in pari delicto test. Since Old Dictaphone was the

victim rather than a perpetrator of the alleged fraud, the trustee's thesis runs, it bears less responsibility than any of the defendants and, therefore, the defendants fail to satisfy the first precondition for use of the in pari delicto defense. On that basis, the trustee claims an entitlement to recover for the injury that Old Dictaphone suffered when it was duped into proceeding with the merger.

We assume, for argument's sake, that Old Dictaphone would have been a proper party to sue for the asserted injury. See supra Part II (A). Even so, the trustee's reasoning is flawed; his analysis entirely overlooks that, pursuant to both the merger agreement and the governing law, see *Del. Code Ann. tit. 8, § 259(a)*, upon the consummation of the merger Old Dictaphone vanished into thin air and New Dictaphone inherited all of Old Dictaphone's choses in action. Under the approved plan of reorganization incident to New Dictaphone's bankruptcy, those litigation rights were passed along once more—this time to the Trust (and, thus, to the trustee). See *11 U.S.C. § 541(a)(1)*. Because the lineage of the trustee's claims passes directly through New Dictaphone, any right that the trustee may have to assert those claims derives directly from New Dictaphone. This chain of descent means that the trustee—despite his protestations to the contrary—is not acting in the place and stead of Old Dictaphone but, rather, in the place and stead of New Dictaphone.

This genealogy is important. Giving effect to it, the trustee may assert only those claims that New Dictaphone could have asserted prior to seeking the protection of the bankruptcy court. See *Mediators, Inc. v. Manney (In re Mediators, Inc.), 105 F.3d 822, 826 (2d Cir. 1997)*; see also *11 U.S.C. § 541*. After all, a trustee in bankruptcy cannot and does not acquire rights or interests superior to, or greater than, those possessed by the

debtor. See *Edwards, 437 F.3d at 1150*; 5 *Collier on Bankruptcy § 541.04* (15th ed. 2006) (noting that "nothing in *section 541* [of the Bankruptcy Code, defining property of the estate] can revest a debtor with property lost prepetition" and describing property of the estate as including "causes of action").

Given the line of descent delineated by operation of the corporation and bankruptcy laws, we think that the in pari delicto defense must be available to a defendant in an action by a bankruptcy trustee whenever that defense would have been available in an action by the debtor. See *Edwards, 437 F.3d at 1152*; see also *Baena, 453 F.3d at 7* (assessing the debtor's culpability to determine whether the in pari delicto doctrine barred a bankruptcy trustee's claims). As a necessary corollary of that proposition, there is no "innocent successor" exception available to a bankruptcy trustee in a case in which the defendant successfully could have mounted an in pari delicto defense against the debtor. See *R.F. Lafferty, 267 F.3d at 356-57*.

The explication of these principles suffices to answer the threshold question here. Consistent with both precedent and analytic rigor, we hold that New Dictaphone is the relevant comparator vis-a-vis the defendants for the purpose of determining the viability of the latter's in pari delicto defense. Old Dictaphone's innocence is irrelevant to that inquiry.

D. Applying the Paradigm.

Having determined that New Dictaphone is the entity of interest for purposes of the required comparison, we move to the question of what actions can, at this stage of the proceedings, be imputed to it (and, thus, to the trustee). See *Baena, 453 F.3d at 7*. In an effort to mount a preemptive strike, the trustee posits that because all

imputation inquiries entail fact-specific determinations, an in pari delicto defense that relies on imputed conduct cannot be adjudicated on a motion to dismiss. Although the trustee's premise is partially correct—the extent to which fraudulent conduct can be implied depends heavily on the specific facts of a given case—he casts the net too wide.

The reporters are replete with examples of fact-dominated questions, normally grist for the jury's mill, that may appropriately be resolved by a motion filed pursuant to *Rule 12(b)(6)*. See, e.g., *Epstein v. C.R. Bard, Inc., 460 F.3d 183, 188 (1st Cir. 2006)*; *Rodi, 389 F.3d at 16*. The key is whether the factual scenario, as pleaded, is clear enough to permit peremptory resolution of the dispositive issue. See *Rodi, 389 F.3d at 16* (explaining that when the facts alleged in the complaint preclude a finding in the plaintiff's favor on a particular claim or defense, "a court may enter an order of dismissal under *Rule 12(b)(6)*"). When a case hinges on imputation and the pleaded facts, construed in the light most flattering to the resisting party, dictate imputation, a court is free to decide that question on a motion to dismiss. See, e.g., *Baena, 453 F.3d at 8* (affirming dismissal on in pari delicto grounds after imputing fraudulent conduct to debtor corporation); *Coopers & Lybrand, 322 F.3d at 164*; (noting that the court historically "has affirmed the dismissal of . . . claims on the pleadings upon findings that in pari delicto had been established in the complaints"); *Terlecky, 133 F.3d at 380* (affirming dismissal when the debtor "admit[ted] in his complaint that the debtor's own actions were instrumental in perpetrating the fraud").

We look to state law to ascertain when wrongful conduct should be imputed to a corporation. See *O'Melveny & Myers v. FDIC, 512 U.S. 79, 84, 114 S. Ct. 2048, 129*

L. Ed. 2d 67 (1994); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Nickless (In re Advanced RISC Corp.), 324 B.R. 10, 14 (D. Mass. 2005)*.[3] Here, the case law leaves little doubt that Massachusetts law governs the imputation calculus. See *O'Melveny & Myers, 512 U.S. at 83-85* (emphasizing the importance of the substantive law of the state in which the causes of action arose, rather than the law of the state of incorporation, to determine imputation).

Under Massachusetts law, a parent and its wholly-owned subsidiary are generally regarded as separate and distinct entities. See *United Elec., Radio & Mach. Workers v. 163 Pleasant St. Corp., 960 F.2d 1080, 1091 (1st Cir. 1992)*; *Berger v. H.P. Hood, Inc., 416 Mass. 652, 624 N.E.2d 947, 950 (Mass. 1993)*. Courts may, however, disregard the corporate form when doing so will defeat a fraud practiced by those who control the subsidiary corporation. See *My Bread Baking Co. v. Cumberland Farms, Inc., 353 Mass. 614, 233 N.E.2d 748, 751 (Mass. 1968)*. Relatedly, the fraudulent conduct of persons or entities who exercise complete control over a corporation may be imputed to the corporation when those actors have used the corporation as a vehicle for facilitation of the fraud. See, e.g., *Consove v. Cohen (In*

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[3] To the extent that the trustee's claims are premised on federal statutes, we arguably have discretion to use federal common law, as opposed to state law. See *O'Melveny & Myers, 512 U.S. at 84* (explaining that where a particular cause of action arises under a federal statute, a federal court, for this purpose, writes on a pristine page). Even so, license to apply a uniquely federal test is not tantamount to mandating such a test. Mindful that two of our sister circuits recently have opted for state-law tests of imputation in connection with federal claims, see *Edwards, 437 F.3d at 1149*; *R.F. Lafferty, 267 F.3d at 358*, and that no party to this litigation has requested us to fashion federal common law, we use Massachusetts jurisprudence as the yardstick for measuring imputation across the board.

re Roco Corp.), 701 F.2d 978, 984 (1st Cir. 1983) (applying Massachusetts law and imputing fraudulent conduct of individual who, "as the company's president, director, and sole shareholder, . . . was in a position to control the disposition of its property"); *Merrill Lynch, 324 B.R. at 14-15* (applying Massachusetts law and imputing principals' fraudulent conduct to debtor corporation where the relationship was "one of complete control"); *Demoulas v. Demoulas, 428 Mass. 555, 703 N.E.2d 1149, 1171 (Mass. 1998)* (applying Massachusetts law and denying bona fide purchaser status to a corporation, under an imputation theory, when the "sole voting trustee of 100 percent of the [corporation's] stock" had actual knowledge of adverse claims against the purchased property).

With this backdrop in place, the trustee's remaining arguments against imputing L&H's fraudulent conduct to its wholly-owned subsidiary lack force. The trustee himself has observed that in pari delicto cases often result in imputation of fraudulent conduct to a corporation when those responsible for the scheme are "the sole decision-maker[s] for such entity, exercising complete control over its management." Appellant's Br. at 43 n.21. This observation accurately reflects the case law. See, e.g., *Coopers & Lybrand, 322 F.3d at 164-65* (imputing fraudulent conduct to debtor when complaint established that its controlling shareholders "dominat[ed] and control[ed] the corporation" and were responsible for "orchestrat[ing] the fraudulent conduct"); *R.F. Lafferty, 267 F.3d at 359-60* (imputing fraudulent conduct to debtor corporation and dismissing trustee's case on in pari delicto grounds where the individuals masterminding the fraud were the debtor's sole shareholders); *Merrill Lynch, 324 B.R. at 14-16* (dismissing trustee's action on in pari delicto grounds when debtor corporation was

formed by the defrauders for the express purpose of carrying out the fraudulent plan). Since New Dictaphone, not Old Dictaphone, is the proper focal point of our imputation inquiry, see supra Part II (C), this case fits snugly within that integument. We explain briefly.

Here, the amended complaint leaves no doubt but that L&H played the primary role in contriving the scheme to acquire Old Dictaphone under false pretenses. The amended complaint also establishes that L&H created New Dictaphone (nee Dark) for the express purpose of furthering this artifice. L&H's control over New Dictaphone during the course of the scheme is indisputable. In addition to owning all of New Dictaphone's stock, L&H installed its president, Bastiaens, as New Dictaphone's chief executive officer and sole director. Bastiaens, in turn, ensured New Dictaphone's complicity in the fraud's climactic event when he executed the merger agreement on its behalf.

These uncontroverted facts are telling. Because the amended complaint shows beyond hope of contradiction that L&H created and controlled New Dictaphone in order to perpetrate the harm-producing fraud, we have no principled choice but to impute its conduct to New Dictaphone for the purpose of applying the in pari delicto paradigm. See *Merrill Lynch, 324 B.R. at 15*; *Demoulas, 703 N.E.2d at 1172*; *My Bread Baking, 233 N.E.2d at 751*.

The trustee tries to find sanctuary by pointing out that, after the merger, the directors of Old Dictaphone (presumably innocent) became directors of New Dictaphone. This datum does not alter our conclusion. The first prong of the in pari delicto inquiry focuses on "the unlawful activity that is the subject of the suit." *Pinter, 486 U.S. at 636*. Accordingly, a party's culpability vel non must be based on its status at the time the alleged illegality

occurred. See *Baena, 453 F.3d at 10* (finding no Massachusetts case law supporting a theory that in pari delicto is in any way modified when "prior management was at fault but the claim [is] asserted on behalf of creditors or shareholders").

Here, of course, the fraud that underpins the trustee's claims was complete at the moment the companies merged. Therefore, any post-merger changes in New Dictaphone's corporate governance or management are beside the point. Simply put, bankruptcy trustees do not have access to an "innocent successor" exception as a way of shielding themselves from the operation of an in pari delicto defense. See *R.F. Lafferty, 267 F.3d at 356-57*; see also *Baena, 453 F.3d at 10*.

The trustee's next attempt to elude the toils of the in pari delicto doctrine involves the well-recognized adverse interest exception. Generally, a wrongdoer's fraudulent acts will not be imputed to a corporation when the wrongdoer is acting contrary to the corporation's present interests. See, e.g., *Baena, 453 F.3d at 8* (listing looting as a "classic example" of adverse conduct); *Sunrise Props., Inc. v. Bacon, Wilson, Ratner, Cohen, Salvage, Fialky & Fitzgerald, P.C., 425 Mass. 63, 679 N.E.2d 540, 543 (Mass. 1997)* (concluding that "unauthorized acts [should] not [be] imputed to the principal when the agent has acted fraudulently toward the principal"). Endeavoring to squeeze within these narrow confines, the trustee contends that L&H's scurrilous conduct is tantamount to looting because L&H convinced Old Dictaphone to surrender its assets for worthless paper.

This contention is ill-conceived, for the trustee's sights are trained on the wrong entity. Accepting the allegations of the amended complaint as true, L&H's actions were adverse to Old Dictaphone and its share-

holders—but they were not adverse to New Dictaphone (a corporate shell which, in effect, was in league with the defrauder and as a result received something for nothing). Since we already have determined that New Dictaphone, not Old Dictaphone, is the focal point of the imputation inquiry, see supra Part II (C), the adverse interest exception does not apply.

The trustee has yet another string to his bow. He argues that even if New Dictaphone is the proper focal point of an in pari delicto analysis, the adverse interest exception precludes us from imputing L&H's fraud to its subsidiary because New Dictaphone was "entirely indifferent" about whether Old Dictaphone received fair value for its assets or whether L&H used skulduggery to effect the acquisition. Appellant's Reply Br. at 19. We find this argument unpersuasive. In our view, mere indifference is insufficient to show adversity. The adverse interest exception applies only to those whom the fraud has disadvantaged. See *Restatement (Second) of Agency § 282(1)* (explaining that the exception attaches only when an agent secretly acts adversely to his principal). In this instance, the allegations of the amended complaint make manifest that New Dictaphone benefitted from the fraud: it was the surviving entity in a merger that netted it over $ 900,000,000. New Dictaphone, as a beneficiary of L&H's chicanery at the time the fraud was consummated,[4] cannot rely on the adverse interest exception to avoid imputation. After all, a party cannot

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[4] Because the adverse interest exception turns on how the alleged wrongdoing affected the immediate interests of the party who seeks its shelter, New Dictaphone's subsequent implosion is of no moment. See *Baena, 453 F.3d at 7*; accord *Beck v. Deloitte & Touche, Deloitte, Haskins & Sells, Ernst & Young, L.L.P., 144 F.3d 732, 736 (11th Cir. 1998)* (applying Florida law); *Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 456 (7th Cir. 1982)* (applying Illinois law).

accept the avails of fraudulent conduct without also bearing responsibility for that conduct. See *Tremont Trust Co. v. Noyes, 246 Mass. 197, 141 N.E. 93, 98 (Mass. 1923)*.

To summarize succinctly, L&H was the main player in the alleged fraud and its parlous behavior must be imputed lock, stock, and barrel to its offspring (New Dictaphone). It follows inexorably that New Dictaphone, in contemplation of law, bears at least as much responsibility for the asserted wrongdoing as any of the defendants.[5] Hence, the moving defendants have satisfied the first requirement for establishing an in pari delicto defense.

We move next to the second requirement. As said, this prong implicates public policy concerns. The trustee contends that allowing the defendants to hide behind the in pari delicto doctrine would frustrate the purpose of the securities laws because it would allow participants in a fraudulent scheme to shield themselves from liability. This contention is wide of the mark.

As we have pointed out, the trustee is not bringing claims on behalf of an innocent target of the fraud but, rather, on behalf of a complicit party. Viewed in that light, the trustee's policy concerns ring hollow.[6] See *Edwards*,

[5] As a fallback, the trustee suggests that the relevant comparison entails matching New Dictaphone's culpability against the culpability of L&H. That suggestion is faulty. When deciding whether to recognize an in pari delicto defense, an inquiring court must consider whether the party alleging injury (here, the trustee, who stands in the shoes of New Dictaphone) bears substantially equal (or greater) responsibility as the party or parties asserting the defense (here, the defendants). See *Bateman Eichler, 472 U.S. at 306* (emphasizing the relative culpability of the "[defending] party" as compared to the plaintiff (alteration in original)). RL&H is not a defendant in this action.

[6] In all events, dismissing the claims at issue here will not allow the defendants to escape unscathed. The amended complaint and matters susceptible to judicial notice reveal that many of the

437 F.3d at 1155 (finding public policy exception inapplicable in analogous circumstances).

The trustee also asserts that withholding application of the in pari delicto doctrine would promote the goal of "discourag[ing] wrongdoers from engaging in future fraudulent schemes and violations of the securities laws." Appellant's Br. at 38. That resupinate reasoning turns reality on its head. To permit the trustee to proceed in these circumstances would be equivalent to giving New Dictaphone a second bite at the cherry, allowing it first to reap the benefits of the fraud and then to attack the defrauders. The securities laws were enacted to protect investors from deceptive practices, see *Pinter, 486 U.S. at 638*, not to give the intended beneficiaries of deceptive practices a back-door means of ensuring a profit.

Finally, the trustee strives to persuade us that we should repel the defendants' in pari delicto defense because, in the absence of that defense, the creditors of Old Dictaphone ultimately would receive the fruits of any recovery. We find this argument unconvincing; despite the interposition of the in pari delicto defense, the creditors remain free to proceed in their own right, untainted by New Dictaphone's role in the alleged wrongdoing. See *Edwards, 437 F.3d at 1151*; *Terlecky, 133 F.3d at 380*; *Merrill Lynch, 324 B.R. at 16*.

This arrangement is especially preferable because the Trust beneficiaries may well include parties (most notably L&H) who were themselves complicit in the underlying fraud. If we were to suspend the operation of the in pari delicto defense in this case, creditors with unclean hands would profit equally with innocents. If,

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defendants are facing or have faced not only criminal charges but also a myriad of other civil suits relating to their respective roles in the alleged fraud.

however, each creditor must proceed by individual suit, the righteous may recover while the tainted, unable to circumvent the in pari delicto bar, will be hoist by their own petard.

At oral argument, the trustee insisted that the alternative of direct suits by creditors is illusory because creditors lack contractual privity with the investment bankers, lawyers, and accountants who comprise the trustee's targets. Thus, the argument runs, if we afford these targets the safe haven of an in pari delicto doctrine, creditors will be completely foreclosed from accessing those pockets that are deep enough to compensate them at anything higher than pennies on the dollar.

This jeremiad is unavailing. Even assuming that the trustee's premise is true—and we have some doubt about its validity—the equities are not nearly so clear-cut. First, the creditors (or the trustee, on their behalf) may well succeed in suits against Old Dictaphone's former directors, controlling shareholder, and outside accounting professionals. See supra note 1. Second—and more important—our holding today breaks no new ground. As such, the potential for default under these circumstances is something about which creditors had notice—something that should have been priced into their decisions to extend credit. Equity does not require courts to provide a belt when creditors had fair warning that they ought to have purchased suspenders.

III. CONCLUSION

To summarize, we conclude that uncontroverted facts sufficient to establish the in pari delicto defense are definitively ascertainable from the amended complaint and other allowable sources of information. These include L&H's creation of New Dictaphone for the express purpose of effectuating the fraud-inspired

merger and its exercise of complete control over New Dictaphone until the fraud was consummated. In these circumstances, L&H's conduct must be imputed to New Dictaphone. Consequently, New Dictaphone shares the culpability of the fraud's progenitor and, as such, bears as much or more responsibility for the wrongdoing as any of the named defendants. In the absence of any compelling public policy reason to allow New Dictaphone to seek damages from those that assisted in executing the fraudulent scheme—and the trustee has identified none—the in pari delicto doctrine precludes New Dictaphone (and, hence, the trustee) from advancing the type of claims that are at issue here.

We need go no further. For the reasons elucidated above, we hold that the district court did not err in dismissing the trustee's amended complaint.

Affirmed.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 03-10843-PBS
August 9, 2004, Decided
August 9, 2004, Filed

ALAN NISSELSON, TRUSTEE OF THE DICTAPHONE LITIGATION TRUST,
Plaintiff,

—v.—

JO LERNOUT, *et al.*,
Defendant.

For Alan Nisselson, Trustee of the Dictaphone Litigation Trust, successor-in-interest to claims of Dictaphone Corporation, Plaintiff: Karen D. Hurvitz, Jamaica Plain, MA; Margaret McGerity, Folkenflik & McGerity, New York, NY; Max Folkenflik, Folkenflik & McGerity, New York, NY; Regina Griffin, Brauner, Baron, Rosenzweig & Klein LLP, New York, NY.

For Jo Lernout, Defendant: Anthony M. Feeherry, Goodwin Procter, LLP, Boston, MA; Gus P. Coldebella, Goodwin Procter, LLP, Boston, MA.

For Pol Hauspie, Nico Willaert, Defendants: Donald H. Chase, Morrison Cohen LLP, New York, NY; Edward P.

Gilbert, Morrison Cohen Singer & Weinstein, LLP, New York, NY; Gordon M. Jones, Nixon Peabody, LLP, Boston, MA; Robert P. Sherman, Nixon Peabody LLP (BOS), Boston, MA.

For Ellen Spooren, Defendant: Michael P. Connolly, Murtha Cullina LLP, Boston, MA.

For Erwin Vanderriessche, RVD Securities, Dick Cauweiler, Marc G.H. DePauw, Girard Van Acker, Defendants: Ada Fernandez Johnson, Debevoise & Plimpton, Washington, DC; John B. Missing, Debevoise & Plimpton, LLP, Washington, DC; Thomas J. Gallitano, Conn, Kavanaugh, Rosenthal, Peisch & Ford, LLP, Boston, MA.

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For Lessius Management Consulting, N.V., Defendant: John Thorpe Richards, Jr, Robert P Trout, Trout & Richards, PLLC, Washington, DC; Peter B. Krupp, Lurie and Krupp, LLP, Boston, MA.

For Gewestelike Investeringsmaatschappij Voor Vlaanderen N.V., Defendant: Thomas J. Gallitano, Conn, Kavanaugh, Rosenthal, Peisch & Ford, LLP, Boston, MA.

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York, NY; Kristin G. McGurn, Seyfarth Shaw, LLP, Boston, MA; Kevin J. Lesinski, Seyfarth Shaw, LLP, Boston, MA.

For Paul Behets, Defendant: Caroline Press, Louis M. Solomon, Proskauer Rose, LLP, New York, NY; Michael J. Stone, Peabody & Arnold LLP, Boston, MA.

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For Chase Securities, Defendant: Dalila A. Wendlandt, Elizabeth Abimbola Thomas, John D. Donovan, Jr., Ropes & Gray LLP, Boston, MA.

For Deloitte & Touche, Defendant: Daniel A. Curto, McDermott, Will & Emery LLP, Boston, MA; Derek J.T. Adler, William R. Maguire, Hughes Hubbard & Reed, LLP, New York, NY; Edward P. Leibensperger, McDermott, Will & Emery, Boston, MA.

For Stonington Partners, Inc., Stonington Capital Appreciation 1994 Fund, L.P, Stonington Holdings, L.L.C., Albert J. Fitzgibbons, Emil F. Jachmann, Alexis P. Michas, Scott M. Shaw, Peter P. Tong, Defendants: Charles P. Kindregan, Looney & Grossman, Boston, MA; Gary J. Mennitt, Dechert LLP (NY), New York, NY.

For John H. Duerden, Defendant: Alan D. Rose, Sr, Michael L. Chinitz, Rose & Associates, Boston, MA; James G. McCarney, Thomas E. Engel, Engel & McCarney, New York, NY; Rupinder Hans, Engel & McCarney, New York, NY.

For Joseph D. Skrzypczak, Defendant: Jill L. Brenner, Donnelly, Conroy & Gelhaar, LLP, Boston, MA;

Jonathan K. Cooperman, Kelley Drye & Warren, New York, NY; Peter E. Gelhaar, Jill Brenner Meixel, Donnelly, Conroy & Gelhaar, LLP, Boston, MA.

For Louis H. Verbeke, Defendant: Andrew Good, Good & Cormier, Boston, MA; Steven M. Salky, Zuckerman Spaeder LLP, Washington, DC; Roger E Zuckerman, Zuckerman Spaeder LLP, Washington, DC.

For Language Investment Company, Willem Hardeman, Defendants: Karen D. Hurvitz, Jamaica Plain, MA.

For KPMG Bedrijfsrevisoren, Defendant: Michael J. Stone, Peabody & Arnold LLP, Boston, MA.

For Mercator Assurances, S.A., Defendant: Janet B. Fierman, Cohen & Fierman, LP, Boston, MA; Thomas W. Evans, Cohen & Fierman, LLP, Boston, MA.

PATTI B. SARIS, United States District Judge.

OPINION:

MEMORANDUM AND ORDER

Saris, U.S.D.J.

I. INTRODUCTION

This case arises out of the stock-for-stock merger of Dictaphone Corporation ("Old Dictaphone") into a subsidiary of Lernout & Hauspie N.V. ("L&H"). An alleged fraudulent scheme at L&H rendered the L&H stock

worthless, and the shareholders sued.[1] Plaintiff Alan Nisselson, Trustee of the Dictaphone Litigation Trust, has filed a separate action alleging that Defendant SG Cowen Securities Corporation ("SG Cowen"), L&H's investment banker, participated in the scheme and defrauded Dictaphone by encouraging it to enter into the merger agreement. Specifically, plaintiff brings claims of common law fraud, unfair trade practices pursuant to *Mass. Gen. Laws. ch. 93A*, negligent mispresentation, conspiracy, and violations of RICO against SG Cowen. SG Cowen moves to dismiss the Amended Complaint in its entirety on the grounds that the Trustee lacks standing because only the shareholders have been injured by the drop in stock value, and the action is barred by the doctrine of in pari delecto. After hearing, the motion to dismiss is **ALLOWED.**

II. FACTUAL BACKGROUND[2]

The Amended Complaint alleges the following facts.

In early 2000, L&H and SG Cowen approached Dictaphone to discuss the possibility of acquiring Dictaphone—one of its major competitors in the speech and language applications sector. At that time, Stonington Fund was the owner of approximately 96% of the autho-

[1] See Stonington Partners, Inc. v. Dammekens, No. 02-10303-PBS (D. Mass. filed Feb. 21., 2002).

[2] This Court has written several extensive opinions concerning the alleged fraudulent scheme at L&H. Familiarity with the facts set out in those opinions is assumed. See, e.g., *In re Lernout & Hauspie Sec. Litig.*, *208 F. Supp. 2d 74 (D. Mass. June 19, 2002)*; *In re Lernout & Hauspie Sec. Litig.*, *230 F. Supp. 2d 152 (D. Mass. Aug. 19, 2002)*; *In re Lernout & Hauspie Sec. Litig.*, *286 B.R. 33 (D. Mass. Nov. 18, 2002)*; *Bamberg v. Cowen*, *236 F. Supp. 2d 79 (D. Mass. Dec. 9, 2002)*; *In re Lernout & Hauspie Sec. Litig.*, *236 F. Supp. 2d 161 (D. Mass. Jan. 13, 2003)*.

rized and outstanding stock of Dictaphone, a Delaware corporation. (P 183.)

On May 5, 2000, in what is known as a "reverse triangular merger," L&H acquired all of the outstanding stock of Dictaphone in exchange for approximately 9.4 million shares of L&H common stock through the merger of Dictaphone into a wholly-owned subsidiary of L&H. The merger was effected pursuant to the terms of The Agreement and Plan of Merger dated March 7, 2000 ("Merger Agreement"). Section 2.1 of the Merger Agreement provided that "without any action on the part of any of the holder [sic] of any shares" of Dictaphone, (1) all shares of Dictaphone stock held as treasury stock "shall be cancelled and retired and shall cease to exist" and (2) every other share of Dictaphone common stock "shall be converted into the right to receive" shares of common stock of L&H, and "all such shares of company common stock, when so converted, shall no longer be outstanding and shall automatically be cancelled and retired and shall cease to exist." The L&H subsidiary, Dark Acquisition Corp., survived the merger and changed its name to Dictaphone Corporation ("New Dictaphone"). (P 44.)

The Merger Agreement contained representations and warranties from L&H to Old Dictaphone, including representations concerning the accuracy of filed financial statements. (PP 207-215.) Cowen made face-to-face representations to Old Dictaphone. (PP 218-220, 387.) Old Dictaphone also hired professional advisors, to whom Cowen made representations about the financial condition of L&H. (PP 193-194, 388(i).)

The consideration Old Dictaphone received for its transfer of $ 900 million in assets to L&H, and the assumption of Old Dictaphone's liabilities, were essentially worthless due to the alleged scheme to fraudu-

lently inflate the value of L&H stock. Plaintiff alleges that SG Cowen had participated in this scheme since early 1997. (PP 125-126.)

On November 29, 2000, New Dictaphone filed for relief under Chapter 11 of the United States Bankruptcy Code with the United States Bankruptcy Court for the District of Delaware. (P 45.) On March 13, 2002, the Bankruptcy Court approved the Third Amended Plan of Reorganization and New Dictaphone was discharged from bankruptcy. Pursuant to the Plan, New Dictaphone, as settler, conveyed all its interest in certain pre-merger claims to the Trustee on behalf of the Dictaphone Litigation Trust. (Id.)

The Trustee seeks to recover the "damages suffered by Dictaphone as a result of [the] fraudulent course of conduct." (P 39.) Plaintiff seeks $900 million in damages, which primarily represents the "loss or diminution of its value as a going concern." (P 390.)

III. DISCUSSION

A. Motion to Dismiss Standard

For purposes of this motion, the Court takes as true "the well-pleaded facts as they appear in the complaint, extending [the] plaintiff every reasonable inference in his favor." *Coyne v. City of Somerville, 972 F.2d 440, 442-43 (1st Cir. 1992)* (citing *Correa-Martinez v. Arrillaga-Belendez, 903 F.2d 49, 51 (1st Cir. 1990)*). A complaint should not be dismissed under *Fed. R. Civ. P. 12(b)(6)* unless " 'it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.' " *Roeder v. Alpha Indus., Inc., 814 F.2d 22, 25 (1st Cir. 1987)* (quoting *Conley v. Gibson, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957)*).

B. Standing

Vigorously contesting the Trustee's standing under Article III of the Constitution, defendant argues that because there was no purchase of corporate assets as part of the merger, there is no harm to Plaintiff apart from the harm to the shareholders. Neither party contests the shareholders' standing to bring claims arising out of the merger, which have been asserted in the separate litigation.

To have standing, "[a] plaintiff must allege personal injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested relief." *Raines v. Byrd, 521 U.S. 811, 818, 138 L. Ed. 2d 849, 117 S. Ct. 2312 (1997)* (quoting *Allen v. Wright, 468 U.S. 737, 751, 82 L. Ed. 2d 556, 104 S. Ct. 3315 (1984)).* "The injury alleged must be, for example, distinct and palpable, and not abstract or conjectural or hypothetical. The injury must be fairly traceable to the challenged action, and relief from the injury must be likely to follow from a favorable decision. " *Allen, 468 U.S. at 751* (internal citations omitted).

The threshold issue, then, is the Trustee's standing to pursue the fraud claims on behalf of the bankrupt corporation. "It is well settled that a bankruptcy trustee has no standing generally to sue third parties on behalf of the estate's creditors, but may only assert claims held by the bankrupt corporation itself." *Shearson Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 118-19 (2d Cir. 1991)* (citing *Caplin v. Marine Midland Grace Trust Co., 406 U.S. 416, 434, 32 L. Ed. 2d 195, 92 S. Ct. 1678 (1972))* (holding that a claim against a third party for defrauding a corporation with the cooperation of management accrues to creditors, not to the guilty corporation); *In re Rare Coin Galleries of Am., Inc., 862 F.2d 896, 901 (1st Cir. 1988)* ("The trustee steps into the shoes of the

debtor for purposes of asserting or maintaining the debtor's causes of action which become property of the estate.") See generally *Caplin, 406 U.S. at 432 n.21* (rejecting argument that reorganization trustee could bring an action for fraud on behalf of individual debenture holders against indenture trustee, and noting that the trustee may well have interests that differ from those of the bondholders). Thus, to resolve whether the Trustee has standing, the Court must determine what claims the bankrupt corporation could have instituted on the date on which the bankruptcy petition was filed. *Shearson, 944 F.2d at 118.* Here, the bankrupt organization is New Dictaphone.

As a general matter, a bankruptcy trustee has standing to assert those claims of the pre-merger entity that were passed on to the (now bankrupt) corporation that survived the merger. See *8 Del. Code Ann. § 259(a)* ("all property . . . shall be vested in the corporation surviving or resulting from such merger or consolidation"). "The right to a pending cause of action is an asset of a merged corporation which passes to the corporation surviving the merger." *Lewis v. Anderson, 477 A.2d 1040, 1043 (Del. 1984)* (holding that plaintiff who ceases to be a shareholder as a result of merger loses standing to prosecute derivative suit); *Heit v. Tenneco, Inc., 319 F. Supp. 884, 887-88 (D. Del. 1970)* (citing *8 Del. Code Ann. § 259*) (holding that when successive mergers were consummated, all of the claims asserted on behalf of the pre-merger corporation were automatically transferred to the post-merger entity).

This case is much complicated by the fact that the bankrupt corporation was wholly-owned by the alleged perpetrator of the fraud. Can a Dr. Jekyll-and-Mr. Hyde corporation sue itself? Can the trustee of the New Dic-

taphone assert the claims of Old Dictaphone against the New Dictaphone's parent?

1. In Pari Delecto

First, Defendant argues that the action is barred by the doctrine of in pari delecto. See *Mediators, Inc. v. Manney (In re Mediators, Inc.), 105 F.3d 822, 825-26 (2d Cir. 1997)* (holding that the wrongdoing of the sole controlling shareholder must be imputed to the corporation). Courts have consistently held that claims for fraud or misrepresentation perpetrated on investors belong exclusively to those investors to the exclusion of the corporation or its successor in interest, where the corporation itself was involved in the wrongdoing. See *Hirsch v. Arthur Andersen & Co., 72 F.3d 1085, 1094 (2d Cir. 1995)* (holding that the trustee in bankruptcy of the consolidated estate of the company and its general partners lacked standing to bring claims predicated upon the distribution of misleading private placement memoranda to investors in limited partnerships because such claims "are the property of those investors, and may be asserted only by them and to the exclusion of [the trustee]."); *Shearson, 944 F.2d at 118* ("When a bankrupt corporation has joined with a third party in defrauding its creditors, the trustee cannot recover against the third party for damage to the creditors."); *E.F. Hutton & Co., Inc. v. Hadley, 901 F.2d 979, 986-87 (11th Cir. 1990)* (holding that bankruptcy trustee lacks standing to bring claims arising out of Ponzi scheme and that claims belonged only to defrauded investors, and expressing concern for "duplicative litigation"); *Williams v. California 1st Bank, 859 F.2d 664, 666-67 (9th Cir. 1988)* (holding that bankruptcy trustee lacked standing to bring claims against bank arising out of bank's participation in Ponzi scheme on behalf of debtor's creditors, even though

creditors assigned trustee their claims, and noting that "inconsistent actions increase the chance that the Trustee will find her interests diverging from those of the investors on whose behalf she is suing").

Accordingly, the Trustee of the "New" Dictaphone (the wholly-owned subsidiary of the alleged perpetrator of the fraud) has no standing to sue a third party on behalf of the defrauded investors. See *Shearson, 944 F.2d at 120* (holding that when the sole stockholder and decisionmaker of a corporation cooperated with a third party in defrauding the corporation, the claim accrued to creditors "not the guilty corporation."); In *Re Roco Corp., 701 F.2d 978, 984 (1st Cir. 1983)* ("We may impute any fraudulent intent of [the sole shareholder] to the transferor [corporation] because, as the company's president, director and sold shareholder, he was in a position to control the disposition of its property.").

Plaintiff seeks to distinguish this caselaw on the ground that "Old Dictaphone" was not involved in the fraud—indeed was the victim of the fraud—and that its injury is distinct from the shareholders who relied on the specific misrepresentations of the parent company. However, Old Dictaphone cannot arise Phoenix-like to assert pre-merger claims against third parties that New Dictaphone could not assert. "Old Dictaphone" does not have independent standing under Delaware Law because its claims passed on to New Dictaphone.

2. Distinct Injury

Second, even if Old Dictaphone has standing independent of New Dictaphone, defendant argues the Trustee lacks standing because the corporation has asserted no injury distinct from the shareholders. The Trustee argues that the shareholders and the corporate party to a merger

may each have standing to pursue remedies for frauds committed against them.

In certain circumstances, courts have allowed both the shareholders and the successor-in-interest to an entity to pursue claims against third-persons who perpetrated a fraud so long as the individual shareholder has "an injury distinct from the injury to the corporation," and "double recovery is not inherent in plaintiff's theory of the case." *Hayes v. Gross, 982 F.2d 104, 108-09 (3d Cir. 1992)* ("Allowing [stockholders] to pursue this claim [to recover for specific misrepresentations that affected prospective purchaser differently from existing shareholders] will neither prejudice the corporation and its other stockholders nor permit a double recovery for the same injury. If [the bank] has claims against its officers and directors arising from their mismanagement, the [successor-in-interest] is free to pursue those claims for the ultimate benefit of the creditors and stockholders of [the bank].")

With respect to the pre-merger entity, the key inquiry for standing purposes is whether the corporation has suffered an injury distinct from the shareholders. See *Howard v. Haddad, 916 F.2d 167, 170 (4th Cir. 1990)* (holding that the purchasers of a bank stock raised direct, non-derivative claims of misrepresentation against the two directors, stating: "There is no compensable injury to the corporation. . . . The mere fact that Howard and the FDIC are pursuing the same source of assets does not transform Howard's claims into derivative ones."); *Reliance Acceptance Group, Inc. v. Levin (In re Reliance Acceptance Group, Inc.), 235 B.R. 548, 555-56 (D. Del. 1999)* ("Debtors and Shareholders are not . . . pursuing the same cause of action" where "Debtors claim [defendants] defrauded the Company in the split-off transaction" and seek "equitable relief" while "Shareholders

. . . claim the [defendants] defrauded them by publishing false and misleading statements that the shareholders relied on in connection with the purchase or sale of . . . securities" and seek "compensatory damages"); *Greenfield v. Shuck, 867 F. Supp. 62, 67, 73 (D. Mass. 1994)* (permitting the claims of plaintiff purchasers of the subordinated capital notes of a failed bank, and the RTC, the bank's successor-in-interest, to proceed on "equal footing" because the purchasers who received personal assurances had direct, non-derivative claims "sufficiently distinct from any injury to the corporation as a whole").

Delaware law provides guidance on the distinction between injury to the corporation and injury to the shareholders. "A derivative claim is one that is brought by a stockholder, on behalf of the corporation, to recover for harms done to the corporation." *Parnes v. Bally Entm't Corp., 722 A.2d 1243, 1245 (Del. 1999).* A direct claim is one in which an individual stockholder or a class of stockholders seeks "relief for direct injuries that are independent of any injury to the corporation." Id. The Delaware Supreme Court recently clarified the law governing when a stockholder's claim is derivative or direct: "That issue must turn *solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery (the corporation or the stockholders, individually)?" *Tooley v. Donaldson, Lufkin, & Jenrette, Inc., 845 A.2d 1031, 1033 (Del. 2004).* "A stockholder who is directly injured . . . does retain the right to bring an individual action for injuries affecting his or her legal rights as a stockholder. Such a claim is distinct from an injury caused to the corporation alone." *Id. at 1036.* The Delaware Supreme Court also emphasized the nature of the duty

owed and the alleged breach. "[A] court should look to the nature of the wrong and to whom the relief should go. . . . The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation." *Id. at 1039.*

The standing issue turns on whether the Trustee has asserted an injury to the corporation caused by Cowen and whether the corporation would receive the benefit of any recovery. The Amended Complaint seeks $900 million in damages, which primarily represents the loss or diminution of its value as a going concern. The obvious problem with this damage theory is that the "Old Dictaphone" is not a going concern, but ceased to exist after the merger. But even if the Trustee surmounts that hurdle, it must allege a distinct pre-merger injury to the corporation.

The $900 million in damages alleged in the Complaint represents approximately $450 million of shares that Old Dictaphone shareholders exchanged for worthless shares of L&H stock. This represents a distinct loss sustained by the shareholders and any recovery would go to them. While defendant may well have owed a duty to Old Dictaphone under the terms of the Merger Agreement, which it allegedly breached by making intentional misrepresentations, Old Dictaphone would not have the right to recover any diminution in the value of the shares caused by the securities fraud. Therefore, under *Tooley*, and the Article III caselaw on standing, only the shareholders have standing to press the claim for the loss arising from the drop in stock value.

Plaintiff claims that the distinct harm to the corporation is approximately $450 million, the amount that creditors had as a claim on the old corporation which was lost as a result of the merger. The problem with this

argument is that the Trustee can assert only the rights of the corporation, not the rights of the creditors. Moreover, the merger was a benefit to Old Dictaphone because New Dictaphone assumed its debts. See *8 Del. Code Ann. § 259(a)* ("All debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said surviving or resulting corporation, and may be enforced against it as if said debts, liabilities and duties had been incurred or contracted by it."); *In re Enron Corp., 292 B.R. 507, 514 (S.D.N.Y. 2002)* (holding that Enron Corp. sustained injuries that were "distinct and separate" from injuries sustained by Enron's shareholders as a result of an unconsummated merger where the merger agreement provided that Enron would have benefitted because its debt would have been assumed by the acquirer). Any separate harm to the value of the old corporation as a going concern is speculative given the facts of this case.

ORDER

The Court **ALLOWS** the motion to dismiss (Docket No. 9).

PATTI B. SARIS

United States District Judge

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 03-10843-PBS
Filed August 13, 2004

ALAN NISSELSON, TRUSTEE OF THE DICTAPHONE LITIGATION TRUST,
Plaintiff,

—v.—

JO LERNOUT, *et al.*,
Defendant.

MEMORANDUM AND ORDER

Saris, U.S.D.J.

For the reasons stated in this Court's Memorandum and Order dated August 9, 2004 (Docket No. 237), Plaintiff Alan Nisselson, Trustee of the Dictaphone Litigation Trust, lacks standing to bring claims under the federal securities laws, Mass. Gen. Laws ch. 93A, RICO, common law fraud, negligent misrepresentation, conspiracy, and breach of fiduciary duty arising out of the alleged fraudulent scheme at Lernout & Hauspie. Therefore, the Court **ALLOWS** the following Motions to Dismiss: Docket No. 32 (Verbeke); Docket No. 74 (Flanders

Language Valley Fund); Docket No. 76 (Flanders Language Valley Fund Management); Docket No. 94 (KPMG LLP); Docket No. 101 (KPMG-B); Docket No. 103 (Lessius Management Consulting); Docket No. 143 (Mercator Assurances); Docket No. 152 (GIMV).

PATTI B. SARIS

PATTI B. SARIS
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 03-CV-10843 (PBS)
Filed March 25, 2005

ALAN NISSELSON, Trustee of the
Dictaphone Litigation Trust, successor-in-interest
to claims of Dictaphone Corporation,

Plaintiff,

—v.—

JO LERNOUT, *et al.*,

Defendants.

FINDINGS AND ORDER FOR ENTRY OF SEPARATE AND FINAL JUDGMENT FOR DEFENDANT LOUIS-H. VERBEKE

After consideration, the Court finds the following:

FINDINGS

1. The claims in each of the above listed actions allege four different types of fraudulent schemes which led to the collapse of the stock price of Lernout & Hauspie Speech Products (L&H) in the late summer and fall of 2000, spanning three continents, against a

multitude of defendants, including L&H former officers, directors and accountants.

2. On August 13, 2004, in response to S.G. Cowen's Motion to Dismiss, this Court decided that the Plaintiff, Alan Nisselson, Trustee of the Dictaphone Litigation Trust ("Plaintiff"), lacks standing to bring claims under federal securities laws, Mass. Gen. Laws. ch. 93A, RICO, common law fraud, negligent misrepresentation, conspiracy, and breach of fiduciary duty arising out of the alleged fraudulent scheme at Lernout & Hauspie ("Asserted Claims"). This Court's Memorandum and Order of August 13, 2004 ordered dismissal of all claims against S.G. Cowen for lack of standing.

3. Based on its conclusion that Plaintiff lacked standing to bring the Asserted Claims, this Court also dismissed all similar claims against other defendants against whom the Plaintiff had filed Asserted Claims, including Defendant Louis-H. Verbeke ("Verbeke").

4. The legal issue of standing present in this Court's Order dismissing Verbeke is legally distinct from any legal and factual issues remaining before this Court and are unlikely to recur to any significant degree upon appeal.

5. There is unlikely to be any overlap between the issues that could be raised in an appeal of this Court's Order dismissing the claims against Verbeke and the contract issues that remain pending in this Court against other defendants.

6. The parties have not completed discovery in connection with the remaining claims. Resolution of all claims against all parties is a considerable period of time away.

7. Although Verbeke has been dismissed as a defendant pursuant to this Court's Orders, if separate and final judgment is not entered on Plaintiff's Asserted Claims against Verbeke, he will continue to be subject to the expense, burden and uncertainty of being a party to a lengthy and complex litigation in a foreign country.
8. There is no just reason for delaying entry of final judgment against the Plaintiff on its Asserted Claims against Verbeke.

ORDER

Accordingly, the Motion for Entry of Separate and Final Judgment is ALLOWED and final judgment shall enter forthwith dismissing all claims against Louis-H. Verbeke in the above action, with prejudice under U.S. law, for lack of standing.

PATTI B. SARIS

Patti B. Saris
United States District Court Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 03-CV-10843 (PBS)
Filed April 4, 2005

ALAN NISSELSON, Trustee of the
Dictaphone Litigation Trust, successor-in-interest
to claims of Dictaphone Corporation,

Plaintiff,

—v.—

JO LERNOUT, *et al.*,

Defendants.

FINDINGS AND ORDER FOR ENTRY OF SEPARATE AND FINAL JUDGMENT FOR MERCATOR AND FOR SIMILARLY SITUATED DEFENDANTS

After consideration, the Court finds the following:

FINDINGS

1. The claims in the above listed action allege fraudulent schemes which led to the collapse of the stock price of Lernout & Hauspie Speech Products (L&H) in the late summer and fall of 2000, against a multi-

tude of defendants, including L&H former officers, directors and accountants.

2. On August 13, 2004, in response to S.G. Cowen's Motion to Dismiss, this Court decided that the Plaintiff, Alan Nisselson, Trustee of the Dictaphone Litigation Trust ("Plaintiff), lacks standing to bring claims under federal securities laws, Mass. Gen. Laws ch. 93A, RICO, common law fraud, negligent representation, conspiracy, and breach of fiduciary duty arising out of the alleged fraudulent scheme at Lernout & Hauspie ("Asserted Claims"). This Court's Memorandum and Order of August 13, 2004 ordered dismissal of all claims against S.C. Cowen for lack of standing.

3. Based on its conclusion that the Plaintiff lacked standing to bring Asserted Claims, the Court also dismissed all similar claims against the other defendants that had filed Motions to Dismiss.

4. The standing issue is factually and legally distinct from the contract issues remaining in the case.

5. There is unlikely to be any overlap between the issues that could be raised in an appeal of this Court's dismissal of the claims against Mercator and similarly situated defendants and the contract issues that will remain pending in this Court against other Deloitte & Touche.

6. The parties have not completed discovery in connection with the remaining claims.

7. If separate and final judgment is not entered on Plaintiff's claims against Mercator, Mercator unnecessarily will continue to be subject to the burden,

expense and uncertainty of being a defendant in complex litigation in a foreign country.

8. There is no just reason for delaying entry of final judgment against the Plaintiff on its claims against Mercator and against similarly situated defendants.

ORDER

Accordingly, Mercator's Motion for Entry of Separate and Final Judgment is ALLOWED and final judgment shall enter forthwith dismissing all claims against Mercator Assurances S.A. and against all other defendants except for Deloitte & Touche, Chase Securities and John H. Duerden in the above action, with prejudice under U.S. law, for lack of standing.

PATTI B. SARIS

Patti B. Saris
Unites States District Court judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

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03 CV 10843 (PBS)
Filed June 7, 2005

ALAN NISSELSON, Trustee of the
Dictaphone Litigation Trust, successor-in-interest
to claims of Dictaphone Corporation,

Plaintiff,

—v.—

JO LERNOUT, *et al.*,

Defendants.

ORDER AND JUDGMENT
AMENDING PRIOR JUDGEMENT

Whereas, the Court having entered an Order directing judgment on April 4, 2005, and

Whereas, the Court did not intend at the time of the entry of the prior Order to enter judgment against Stonington Partners, Inc., Stonington Capital Appreciation 1994 Fund L.P., Stonington Holdings, LLC, Albert J. Fitzgibbons, III, Emil F. Jachmann, Alexis P. Michas, Scott M. Shaw, Joseph O. Skrzypczak, and Peter P. Tong (together the "Former Directors and Shareholders of Old Dictaphone"), but due to the omission of sufficient identification of the parties being dismissed and oversight,

the form of Order proposed and signed provided for a blanket dismissal of all defendants, except for those specifically identified, which inadvertently resulted in dismissal of the Former Directors and Shareholders of Old Dictaphone.

Accordingly, it is hereby ORDERED, pursuant to Fed. R. Civ. P. 60(a), that the Order of April 4, 2005 and Judgment based thereon are hereby amended and modified to the extent inconsistent with this Order, and it is further

ORDERED that Mercator's Motion for Entry of Separate and Final Judgment pursuant to Fed. R. Civ. P. 54(b) is allowed, and final judgment shall enter forthwith dismissing all claims against Jo Lernout, Pol Hauspie, Nico Willaert, Gaston Bastiaens, Carl Dammekens, Ellen Spooren, Ju-Chul Seo, Erwin Vandendriessche, RVD Securities N.V., Dick Cauwelier, Marc G.H. DePauw, Francis Vanderhoydonck, Gerard van Acker, S.ALL. Trust V.Z.W., Flanders Language Valley Fund; Flanders Language Valley Fund Management, Lessius Management Consulting, N.V., Gewestelijke Investeringsmaatschappij Vlaanderen N.V., L&H Investment Company, N.V., Language Investment Company, Language Development Services, Mercator and Noordstar N.V., Language Development Fund; Velstra Pte Ltd., Louis H. Verbeke, Willem Hardeman; Tony Snauwaert, Klynveld Peat Marwick Goerdeler Bedrijfsrevisoven, KPMG LLP, Paul Behets, and SG Cowen Securities Corporation, with prejudice, and without costs for the reasons set forth in my Decision dated August 9, 2004.

PATTI B. SARIS

Patti B. Saris
United States District Court Judge

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 05-1774
Entered: July 7, 2005
Filed: August 8, 2005

ALAN NISSELSON, TRUSTEE OF THE DICTAPHONE LITIGATION TRUST,

Plaintiff, Appellant,

—v.—

JO LERNOUT, ET AL.,

Defendants, Appellees,

CHASE SECURITIES, INC., ET AL.,

Defendants.

ORDER OF COURT

Leave is granted to the district court to enter the June 7, 2005 "Order and Judgment Amending Prior Judgment." Fed. R. Civ. P. 60(a).

By the Court:

Richard Cushing Donovan, Clerk.

BY: MARGARET CARTER
Chief Deputy Clerk.

[certified copies: Hon. Patti B. Saris and Sarah A. Thornton, Clerk]

[cc: Max Folkenflik, Esq., Margaret McGerity, Esq., Karen D. Hurvitz, Esq., Regina Griffin, Esq., Anthony M. Feeherry, Esq., Gus P. Coldebella, Esq., Donald H. Chase, Esq., Edward P. Gilbert, Esq., Gordon Messick Jones, III, Esq., Robert P. Sherman, Esq., Michael P. Connolly, Esq., Ada Fernandez Johnson, Esq., John B. Missing, Esq., David C. Ware, Esq., Thomas J. Gallitano, Esq., John A. Redmon, Esq., Nicholas W. C. Corson, Esq., George A. Salter, Esq., Daniel Curto, Esq., Derek J. T. Adler, Esq., William R. Maguire, Esq., Edward P. Leibensperger, Esq., Charles P. Kindregan, Esq., Gary J. Mennitt, Esq., Alan D. Rose, Esq., James G. McCarney, Esq., Rupinder Hans, Esq., Thomas E. Engel, Esq., Michael L. Chinitz, Esq., Jill Brenner, Esq., Peter E. Gelhaar, Esq., Jonathan K. Cooperman, Esq., Willem Hardeman, Eric Neyman, Esq., Robert J. Kaler, Esq., John Thorpe Richards, Jr., Esq., Robert F. Trout, Esq., Peter B. Krupp, Esq., Diem-Suong T. Nguyen, Esq., Iris Gafni-Kane, Esq., Julian J. Moore, Esq., Michael P. Carroll, Esq., Michael S. Flynn, Esq., Michael L. Simes, Esq., Reshma M. Saujani, Esq., Sean C. Knowles, Esq., Kristin G. McGurn, Esq., Kevin J. Lesinski, Esq., Caroline Press, Esq., Louis M. Solomon, Esq., Michael J. Stone, Esq., Dennis A. Murphy, Esq., Matthew Joseph Matule, Esq., George A. Zimmerman,

Esq., Dalila A. Wendlandt, Esq., Elizabeth Abimbola Thomas, Esq., John D. Donovan, Jr., Esq., Andrew Good, Esq., Steven M. Salky, Esq., Roger E. Zuckerman, Esq., P. Andrew Torrez, Esq., Janet B. Fierman, Esq. and Thomas W. Evans, Esq.]

15 U.S.C. § 78AA

TITLE 15. COMMERCE AND TRADE
CHAPTER 2B. SECURITIES EXCHANGES

§ 78aa. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of title 28, United States Code. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

18 U.S.C. § 1962

TITLE 18. CRIMES AND CRIMINAL PROCEDURE
PART I. CRIMES
CHAPTER 96. RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS

§ 1962. Prohibited activities

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of *section 2, title 18, United States Code* [*18 USCS § 2*], to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which

is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section.

18 U.S.C. § 1964

TITLE 18. CRIMES AND CRIMINAL PROCEDURE
PART I. CRIMES
CHAPTER 96. RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS

§ 1964. Civil remedies

(a) The district courts of the United States shall have jurisdiction to prevent and restrain violations of section 1962 of this chapter [*18 USCS § 1962*] by issuing appropriate orders, including, but not limited to: ordering any person to divest himself of any interest, direct or indirect, in any enterprise; imposing reasonable restrictions on the future activities or investments of any person, including, but not limited to, prohibiting any person from engaging in the same type of endeavor as the enterprise engaged in, the activities of which affect interstate or foreign commerce; or ordering dissolution or reorganization of any enterprise, making due provision for the rights of innocent persons.

(b) The Attorney General may institute proceedings under this section. Pending final determination thereof, the court may at any time enter such restraining orders or prohibitions, or take such other actions, including the acceptance of satisfactory performance bonds, as it shall deem proper.

(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter [*18 USCS § 1962*] may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee, except that no person may rely upon any conduct that would have been action-

able as fraud in the purchase or sale of securities to establish a violation of section 1962 [*18 USCS § 1962*]. The exception contained in the preceding sentence does not apply to an action against any person that is criminally convicted in connection with the fraud, in which case the statute of limitations shall start to run on the date on which the conviction becomes final.

(d) A final judgment or decree rendered in favor of the United States in any criminal proceeding brought by the United States under this chapter [*18 USCS §§ 1961* et seq.] shall estop the defendant from denying the essential allegations of the criminal offense in any subsequent civil proceeding brought by the United States.

28 USCS § 1254

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART IV. JURISDICTION AND VENUE
CHAPTER 81. SUPREME COURT

§ 1254. Courts of appeals; certiorari; certified questions

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

(2) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

28 U.S.C. § 1337

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART IV. JURISDICTION AND VENUE
CHAPTER 85. DISTRICT COURTS; JURISDICTION

§ 1337. Commerce and antitrust regulations; amount in controversy, costs

(a) The district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies: *Provided, however,* That the district courts shall have original jurisdiction of an action brought under section 11706 or 14706 of title 49, only if the matter in controversy for each receipt or bill of lading exceeds $ 10,000, exclusive of interest and costs.

(b) Except when express provision therefor is otherwise made in a statute of the United States, where a plaintiff who files the case under section 11706 or 14706 of title 49, originally in the Federal courts is finally adjudged to be entitled to recover less than the sum or value of $ 10,000, computed without regard to any setoff or counterclaim to which the defendant may be adjudged to be entitled, and exclusive of any interest and costs, the district court may deny costs to the plaintiff and, in addition, may impose costs on the plaintiff.

(c) The district courts shall not have jurisdiction under this section of any matter within the exclusive jurisdiction of the Court of International Trade under chapter 95 of this *title [28 USCS §§ 1581* et seq.].

28 USCS § 1367

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART IV. JURISDICTION AND VENUE
CHAPTER 85. DISTRICT COURTS; JURISDICTION

§ 1367. Supplemental jurisdiction

(a) Except as provided in subsections (b) and (c) or as expressly provided otherwise by Federal statute, in any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution. Such supplemental jurisdiction shall include claims that involve the joinder or intervention of additional parties.

(b) In any civil action of which the district courts have original jurisdiction founded solely on section 1332 of this *title [28 USCS § 1332]*, the district courts shall not have supplemental jurisdiction under subsection (a) over claims by plaintiffs against persons made parties under *Rule 14, 19, 20, or 24 of the Federal Rules of Civil Procedure*, or over claims by persons proposed to be joined as plaintiffs under Rule 19 of such rules, or seeking to intervene as plaintiffs under Rule 24 of such rules, when exercising supplemental jurisdiction over such claims would be inconsistent with the jurisdictional requirements of section 1332 [*28 USCS § 1332*].

(c) The district courts may decline to exercise supplemental jurisdiction over a claim under subsection (a) if—

(1) the claim raises a novel or complex issue of State law,

(2) the claim substantially predominates over the claim or claims over which the district court has original jurisdiction,

(3) the district court has dismissed all claims over which it has original jurisdiction, or

(4) in exceptional circumstances, there are other compelling reasons for declining jurisdiction.

(d) The period of limitations for any claim asserted under subsection (a), and for any other claim in the same action that is voluntarily dismissed at the same time as or after the dismissal of the claim under subsection (a), shall be tolled while the claim is pending and for a period of 30 days after it is dismissed unless State law provides for a longer tolling period.

(e) As used in this section, the term "State" includes the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

17 CFR 240.10b-5

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.